APPENDIX B

IN THE UNITED STATES COURT OF CLAIMS

No. 142—58

(Decided May 10, 1963)

MORTON SALT COMPANY, A CORPORATION v. THE UNITED STATES

Before JONES, *Chief Judge*, WHITAKER, LARAMORE, DURFEE and DAVIS, *Judges*.

OPINION

JONES, *Chief Judge*, delivered the opinion of the court:

Plaintiff, an Illinois corporation having its principal place of business in Chicago, is engaged in the pursuit of extracting, processing, and selling salt in its various forms and grades. As a salt producer, plaintiff is entitled to deduct from its income and excess profits taxes amounts based upon an allowance for the depletion of its mineral resources. Plaintiff seeks a refund of its taxes for the years 1951, 1952, 1953, and 1954 on the ground that it was not permitted to base its computations for depletion allowance on its gross income derived from the sale of finished products in those years. Taxpayer's claim for the first three years in question is predicated upon the provisions of the Internal Revenue Code of 1939 while its 1954 claim is derived from similar provisions of the Internal Revenue Code of 1954.

Section 23(m) of the Internal Revenue Code of 1939[1]

[1] Section 23(m) provides as follows:

"(m) Depletion.

"In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciа-

provides for a reasonable depletion allowance for the mineral mining industry according to regulations to be prescribed by the Commissioner of Internal Revenue. The basis for this depletion allowance is as set forth in section 114[2] of that Code, and establishes that sodium chloride

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tion of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner, with the approval of the Secretary. * * *." 26 U.S.C. § 23(m) (1952).

[2] "§ 114. Basis for depreciation and depletion—

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"(b) Basis for depletion—

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"(4) Percentage depletion for coal and metal mines and for certain other mines and natural mineral deposits.

"(A) In general.

"The allowance for depletion under section 23(m) in the case of the following mines and other natural deposits shall be—

"(i) in the case of sand, gravel, slate, stone (including pumice and scoria), brick and tile clay, shale, oyster shell, clam shell, granite, marble, sodium chloride, and, if from brine wells, calcium chloride, magnesium chloride, and bromine 5 per centum.

* * * * * *

of the gross income from the property during the taxable year, excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property, except that in no case shall the depletion allowance under section 23(m) be less than it would be if computed without reference to this paragraph.

"(B) Definition of gross income from property.

"As used in this paragraph the term 'gross income from the property' means the gross income from mining. The term 'mining' as used therein shall be considered to include not merely the extraction of the ores or minerals from the ground but also the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products. * * *"

26 U.S.C. § 114 (1952). For the definition of "ordinary treatment processes," see note 10, *infra*.

(salt) is to be depleted at 5 per centum of the gross income from the property during the taxable year. Such "gross income," the Code explains, means "gross income from mining." Mining includes "not merely the extraction of ores or minerals from the ground but also the ordinary treatment processes normally applied by the mine owners or operators in order to obtain the commercially marketable mineral product or products." These same provisions are carried forward essentially unchanged into the Internal Revenue Code of 1954, except that the depletion rate for sodium chloride is increased to 10 percent.[3] For simplicity, then, we shall treat all plaintiff's claims as though they arose under the earlier statutory provisions.

The sole issue[4] presented for decision in this case arises from plaintiff's contention that all of its processes, including the packaging of its salt, are "normally applied" by miners in order to obtain a commercially marketable product within the meaning of the depletion statute and associated Treasury Regulations.[5]

Plaintiff produces salt by hydraulic mining (brine wells)

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[3] For the depletion provisions of the Internal Revenue Code of 1954, see 26 U.S.C. § 613 (1958).

[4] Plaintiff's petition sounds in four counts. Count I sets out plaintiff's claim for refund of taxes based upon its depletion allowance computations for 1951, 1952, and 1953. Count III sets forth a similar claim for 1954. Counts II and IV relate to deficiencies assessed against taxpayer with respect to amounts received in excess of cost upon the sale of shares of treasury stock to its employees. As indicated in finding 55 of the trial commissioner's report, counts II and IV have been stipulated and are not in issue before the court.

[5] For the tax regulations relating to the 1939 Code provisions, see Treasury Regulation 118, section 39.23(m)–1(e). In respect to the Internal Revenue Code of 1954, see § 1.613–3, Proposed Treasury Decision, published 11–3–56.

and dry mining (rock salt mines). The salt so produced falls into three basic categories: evaporated granulated salt, evaporated flake or grainer salt, and rock salt. The rock salt is produced by the dry mining method while both of the evaporated forms, basically, are produced by applying a heat evaporation process to the salt received in solution from the brine wells. These mining methods, with minor variations, are identical with those employed by other members of the salt industry. Since there are few secrets within the industry and since the systems are basically simple in principle, standardization is widespread. The process of dry mining, for example, has not been substantially changed in more than 50 years. As the parties have stipulated, and the trial commissioner has found, the treatment processes applied by plaintiff at its plants, with respect to the three basic types of salt, were as follows:

TABLE 1

Evaporated granulated salt		Evaporated flake or grainer salt		Rock salt	
Stage	Process	Stage	Process	Stage	Process
1	Underground brining and pump lift at wells.	1	Underground brining and pump lift at wells.	1	Undercutting, drilling and blasting.
2	Treatment to remove brine impurities.	2	Treatment to remove brine impurities.	2	Underground conveying.
3	Vacuum pan evaporation.	3	Open pan and flash evaporation.	3	Through grizzly and primary crusher (underground).
4	De-watering.	4	De-watering.	4	Conveying and hoisting.
5	Kiln drying.	5	Kiln drying.	5	Scavenge screening.
6	Screening.	6	Screening.	6	Grinding.
7	Introduction of additives where required.	7	Introduction of additives where required.	7	Screening.
8	Bulk loading.	8	Bulk loading.	8	Kiln drying. (fine grades per seasonal requirements).
9	Packaging and block presses.	9	Packaging.	9	Introduction of additives where required.
10	Package loading.	10	Package loading.	10	Bulk loading.
				11	Packaging and block presses.
				12	Package loading.

Plaintiff takes the position that its production cycle is closed and continuous. As plaintiff's counsel expresses it, plaintiff

> * * * starts out with sodium chloride underground, it moves its sodium chloride through a closed production circuit with gravity as the important propelling factor and at the end of that production circuit it loads its sodium chloride products on board transportation units at its plants. [Brief for the petitioner, p. 46.]

This position is the fabric of petitioner's ultimate contention that it is entitled to a depletion allowance computed by taking the permitted percentage of its net sales of all its salt products, and that the net sales equal gross income from those sales less returns, allowances, freight, warehousing, and salt purchased for resale. Defendant, on the other hand, maintains that plaintiff's crude extraction product is brine at the wellhead (in the case of brine wells), and rock salt from the muck pile (in the dry mining operation). If this contention were adopted with its full implications, plaintiff would be restricted to an allowance based upon only that percentage of gross income attributable to the mining of salt to these points and no further. Alternatively, the Government contends that all processes through drying and screening (step 6 for the evaporated salts and step 7 for rock salt, Table 1, *supra*) are allowable,[6] but that percentages of gross income attributable to the introduction of additives, compressing, and packaging, are excluded. For reasons hereinafter set forth, we adopt the latter position.

Depletion at its inception in 1913,[7] was designed to make

[6] As the trial commissioner reported in finding 51, this position is the one adopted by the Commissioner of Internal Revenue in passing upon plaintiff's claim.

[7] The initial depletion allowance program was established by the Income Tax Act of 1913, 38 Stat. 167.

an allowance for the exhaustion of the mineral resources of a producer on the basis of the market value of the mineral at the mine. In 1918, the Congress authorized the introduction of the "discovery" concept of depletion.[8] In 1926, because the earlier methods created extreme administrative problems relating to the proper methods of determining "value," the system of percentage depletion was introduced into the computation of allowances with regard to the gas and oil industries.[9] At subsequent intervals other minerals and mining products were added to the approved list of depletable items, sodium chloride being included by section 319 of the Revenue Act of 1951, 65 Stat. 497.

Throughout the long history of depletion, it has been clear that the Congress intended to tax only the income from mining without touching the resources upon which the mine depended. The underlying depletion theory has always been to make an allowance from income for the exhaustion of the wasting assets. *United States* v. *Cannelton Sewer Pipe Co.*, 364 U. S. 76, 81 (1960). For that reason it is important in this case to determine with accuracy the cut-off point between "mining" and "manufacturing" in the salt industry. The statute specifies that "mining" includes not just the process of extraction but also the processes normally applied by the miners to prepare their product or products for market. Section 114(B) defines "ordinary treatment processes" by means of inclusion.[10] Although

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[8] Revenue Act of 1918, 40 Stat. 1067.

[9] Revenue Act of 1926, 44 Stat. 16. Section 204(c)(2) of that Act provided: "In the case of oil and gas wells the allowance for depletion shall be 27½ per centum of the gross income from the property during the taxable year."

[10] "The term 'ordinary treatment processes', as used herein, shall include the following:

"(iii) in the case of iron ore, bauxite, ball and sagger clay, rock

sodium chloride is not included as such, we feel that these statutory delineations are helpful in that they indicate the type of processes intended by the Congress to be a part of mining. In each of the four statutory classifications, the allowable processes are directed at preparing crude ores or minerals for earliest sale prior to formal refining. This is emphasized by the express exclusion of thermal or electric smelting, refining, roasting, and other similar processes. Of course it would be arbitrary to insert salt into any one of these classifications at this point, and we do not attempt to do so.

In the application of the theory to the facts, we believe that the decision of the Supreme Court in the case of *United States* v. *Cannelton Sewer Pipe Co., supra*, is controlling. In that case the plaintiff mined raw fire clay and shale and manufactured it into a high-grade sewer pipe. The record showed that the Cannelton Company was unable to market raw clay profitably because the cost of transporting the clay to the nearest market alone exceeded the market price for that commodity. It was clear, however, that there did exist a substantial industry-wide market for raw clay. The Supreme Court, in reversing the Seventh Circuit,[11] held that "commercially marketable" did not mean marketable at a profit and that the plaintiff was its own economical market for its raw clay. The result of this was that the Cannelton Company was forced to compute its

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asphalt, and minerals which are customarily sold in the form of a crude mineral product—sorting, concentrating, and sintering to bring to shipping grade and to in, and loading for shipment; and (iv) in the case of lead, zinc, copper, gold, silver, or fluorspar ores, potash, and ores which are not customarily sold in the form of the crude mineral product—crushing, grinding, and beneficiation by concentration, • • • cyanidation, leaching, crystallization, precipitation • • • " 26 U.S.C. § 614(B) (1952).

[11] *Cannelton Sewer Pipe Co.* v. *United States*, 268 F. 2d 334 (7th Cir. 1959).

depletion allowance only on that portion of its gross income attributable to the constructive sale of raw clay to itself.

Defendant interprets this decision as requiring us to locate the cutoff point at the place where the *first* marketable product of the mine is produced, thus placing a gloss on the statutory language. In *Cannelton*, raw clay was the first product to be removed from the ground. The Court said:

> Ever since the first percentage depletion statute, the cut-off point where "gross income from mining" stopped has been the same, i.e., where the ordinary miner shipped the product of his mine. [*United States* v. *Cannelton Sewer Pipe Co.*, *supra*, at 87.]

To determine the character of the ordinary product, it was essential to investigate the nature of the sales of the raw product on an industry-wide scale, and not restricted solely to the practices of the Cannelton Company. In this regard the Court said:

> The findings are that three-fifths of the fire clay produced in Indiana in 1951 was sold in its raw state. *This indicates a substantial market for the raw material.*
>
> . . . . . .
>
> Proof of these sales is significant not because it reveals an ability to sell profitably—which the respondent could not do—but *because the substantial tonnage being sold in a raw state provides conclusive proof that, when extracted from the mine, the fire clay and shale are in such a state that they are ready for industrial use or consumption*—in short, they have passed the "mining" state on which the depletion principle operates. [*United States* v. *Cannelton Sewer Pipe Co.*, *supra*, at 86. (Emphasis added.)]

This language, taken in the context of that case, makes it clear that the salient feature was the substantial nature of

the clay mined. This consideration has been borne out in a whole series of subsequent cases[12] and it controls the instant case.

We shall first consider the hydraulic mining aspect of plaintiff's operations. Because the Commissioner of Internal Revenue assessed the plaintiff on the assumption that step 6, Table 1, was the proper cutoff point in the computation of depletion allowance for the brine well production of salt, we are not in a position procedurally to consider whether the proper cutoff point should be placed prior to step 6. We need only decide whether, in the light of *Cannelton*, it should be located at some later point so as to include some or all of the additional steps.

To take 1954 as a typical year of the period in question, some 12 million short tons of brine were sold or used in comparison with approximately 8½ million tons of salt in the dry form.[13] It is true that this large quantity of brine was used chiefly by chemical companies which produced brine for their own use, and not for sale to others. It is also true that in the years in question, plaintiff produced little or no brine for sale. But the *Cannelton* case teaches us that these considerations are immaterial. To borrow from the language of that case, modified to our own use, these sales are significant "because the substantial tonnage being

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[12] This principle was reaffirmed in *Riddell* v. *Monolith Portland Cement Co.*, No. 528 S. Ct., January 14, 1963. Reversed and remanded on the strength of *Cannelton*. In the lower courts, see *e.g.*, *Riddell* v. *Victorville Lime Rock Co.*, 292 F. 2d 427 (9th Cir. 1961); *Commissioner* v. *Halquist*, 291 F. 2d 49 (7th Cir.), *cert. denied*, 368 U.S. 930 (1961); *Standard Realization Co.* v. *United States*, 289 F. 2d 247 (7th Cir. 1961); *U.S. Pumice Supply Co.* v. *Commissioner*, 36 T.C. 1160 (Sept. 29, 1961); *Vulcan Materials Co.* v. *Sauber*, 7 AFTR 2d 1130 (1961); *Fannin Investment Co.* v. *United States*, 197 F. Supp. 693 (N.D. Ga. 1961).

[13] Bureau of Mines Minerals Yearbook, 1954, Vol. 1.

sold in a raw state provides conclusive proof that, when extracted from the [ground], the [salt] is in such a state that [it] is ready for industrial use or consumption." Thus at stage 6, if not sooner, salt was produced in substantially marketable quantities within the meaning of the statute.

We now consider the dry mining portion of the case. As examination of the record shows that out of approximately 20 million tons of salt produced annually between 1951 and 1954, roughly 5 million tons were rock salt. While plaintiff produced a very low percentage (1.30 percent average) of rock salt for sale prior to step 10, four other major producers[14] in those same years sold about half of their total production in bulk form at step 7 of the dry salt process. Since there is no showing of any appreciable sales in the industry prior to this step, we conclude that this is the proper cutoff point, as determined by the Commissioner of Internal Revenue for salt produced by dry mining.

Plaintiff would have us distinguish the *Cannelton* decision on the ground that the producer in that case was integrated, while plaintiff herein is a nonintegrated producer. While it is true that plaintiff does not utilize its salt in the production of any other product that is chemically or physically different, there is some doubt as to the validity of that conclusion. Be that as it may, we believe the distinction to be without legal significance. It is apparent that the Supreme Court referred to the integrated nature of the producer in *Cannelton* only for the limited purpose of showing that the integrated producer was entitled to no benefits superior to nonintegrated counterparts. *United States* v. *Cannelton Sewer Pipe Co.*, *supra*, at 86-87. There

[14] International Salt Co., Diamond Crystal Salt Co., Carey Salt Co., and Watkins Salt Co. We accept these as representative, since they appear in the record by stipulation of the parties.

is no such distinction suggested by section 114 of the Code. In addition, we find the pre-*Cannelton* cases stressed by plaintiff to be unpersuasive in this case. As indicated by the Supreme Court, these cases for the most part go off on concessions not present in our case, or they are predicated upon the misconception corrected in *Cannelton* that for a product to be commercially marketable, its sale must produce a profit to the plaintiff.[15] By comparison, the post-*Cannelton* decisions[16] are consistent in their nonsupport of plaintiff's contentions.

As we have previously stated, the procedural aspect of this case constrains us to agree with the Commissioner of Internal Revenue that all processes subsequent to screening and drying be disallowed; thus, plaintiff's petition as to Counts I and III must be dismissed. By a stipulation filed

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[15] See the Court's summation in note 10, *United States* v. *Cannelton Sewer Pipe Co.*, 364 U.S. at 89. The series of cases commencing with *United States* v. *Cherokee Brick & Tile Co.*, 218 F. 2d 424 (5th Cir. 1955) and culminating with *United States* v. *Merry Bros. Brick & Tile Co.*, 242 F. 2d 708 (5th Cir. 1957) were decided on the basis of concessions made by the Government. In *Cherokee*, for example, counsel for the Government admitted the crucial fact that only negligible quantities of raw clay were sold before being converted to brick. In *Commissioner* v. *Iowa Limestone Co.*, 269 F. 2d 398 (8th Cir. 1959), and like cases, the decision turned on the "profitability" test rejected in *Cannelton*.

[16] See, *e.g.*, the cases cited in n. 12, *supra*. In the *Halquist* case, plaintiff claimed that veneer stone was its marketable product but the court held that "in the light of Cannelton," processing rough uncut blocks of stone into veneer blocks could not be considered "mining." The court said that, lacking local information as to the marketability of rough stone, it must make recourse to the industry in general. In *Standard Realization*, where over 60 percent of plaintiff's product was shipped in the form of bulk silica sand without grinding or bagging, the court excluded these latter processes from the computation. The remainder of the cited cases follow in suit.

June 13, 1960, the parties agreed that (1) with respect to the allegations contained in Count II, plaintiff is entitled to recover the amount of the deficiencies paid, together with interest thereon as provided by law, and (2) with respect to the allegations contained in Count IV, plaintiff is entitled to recover an amount equal to 67½ percent of the amount of the deficiency set forth in that count, together with interest thereon as provided by law. For that reason plaintiff is entitled to recover on Counts II and IV of its petition and judgment will be entered to that effect.

The exact amount of recovery will be determined pursuant to Rule 38(c) of the Rules of this court.

FINDINGS OF FACT

The court, having considered the evidence, the report of Trial Commissioner Saul Richard Gamer, and the briefs and argument of counsel, makes findings of fact as follows:

1. Plaintiff is an Illinois corporation having its principal place of business in Chicago, Illinois. It produces and sells salt by the methods and in the forms and grades hereinafter described.

2. Plaintiff has kept its accounts on the accrual basis of accounting and made its Federal income tax and excess profits tax returns for the years involved herein on that basis of accounting. It reported on the calendar year basis, which is the basis upon which its books of account were kept.

3. Plaintiff duly filed its income tax and excess profits tax returns for the years 1951, 1952 and 1953 and its income tax return for 1954 with the office of the United States District Director of Internal Revenue (formerly Collector of Internal Revenue) at Chicago, Illinois.

4. Plaintiff produces salt by hydraulic mining (brine

wells) and dry mining (rock salt mines) and was entitled to take percentage depletion at the annual rate of 5 percent for the years 1951, 1952 and 1953, and at the annual rate of 10 percent for the year 1954. Salt is known chemically as sodium chloride (NaCl).

5. Plaintiff is a member of the salt industry. It is engaged in the extraction, processing and marketing of dry salt (sodium chloride). Sodium chloride is a nonmetallic mineral and is an edible product. In addition to plaintiff, but excepting dry salt producers using the solar method of production, which is not involved here, the principal members of the industry engaged in the production and sale of dry salt during the years involved herein were The International Salt Company, Diamond Crystal Salt Company, Jefferson Island Salt Company, Watkins Salt Company, Hardy Salt Company, Barton Salt Company, Carey Salt Company, Gordy Salt Company, United Salt Company, and Michigan Salt Company. The areas in the United States from which dry salt is produced are generally known as New York, Ohio, Michigan, Kansas, Utah, California, Texas and Louisiana. Plaintiff has a plant in each such producing area.

6. During the years involved herein, plaintiff produced salt by means of hydraulic mining at its plants located in Silver Springs, New York; Port Huron, Michigan; Manistee, Michigan; Rittman, Ohio; Hutchinson, Kansas; Weeks Island, Louisiana; and Grand Saline, Texas; and by means of dry mining at its plants in Weeks Island, Louisiana, and Grand Saline, Texas. Plaintiff also produced salt by means of a solar operation at its plant located in Saltair, Utah, but the gross income from the production of salt at that plant was not included by plaintiff in the depletion computation in its returns. The choice of method of extraction as between hydraulic mining and dry mining depends upon a number of factors such as the quality of the sodium chloride de-

posit, the depth of the deposit, and the requirements of the proximate market for salt.

7. The basic pattern of plaintiff's production from its hydraulic mining operation (brine wells) was as follows:

(a) Water was pumped into the sodium chloride deposit which is dissolved and the resulting salt in solution (brine) was pumped to the surface.

(b) From the wellhead the brine was introduced into settling tanks where impurities were precipitated out.

(c) From settling tanks the brine was introduced into either vacuum pans or open grainer pans, depending upon the type and grade of salt required, and in both cases heat was applied for evaporation purposes.

(d) The salt which had been crystallized in either vacuum pans or grainers was next de-watered and then kiln dried, except for certain amounts which were shipped and sold in bulk form. The amount of such salt sold at this stage in bulk form is hereinafter set forth.

(e) After kiln drying, the dry salt was run through screens of various mesh sizes to produce a variety of screen grades.

(f) After the screening operation, all of the following operations would normally take place on a gravity flow basis:

(1) The resulting screen grades, except as noted in (2) and (3) below, were routed into packaging lines, with the package sizes ranging from .4 ounce table salt miniatures to 100 pound bags of salt for industrial uses.

(2) Some of the screen grades were routed through hydraulic presses and other types of compression equipment for the production of 50-pound blocks and small bricks, spools, pellets and tablets.

(3) Some of the screen grades were shipped in bulk form.

(4) Between the screening and packaging or compression operations, various additives, for the purpose of either enhancing the free running qualities of the salt or providing food fortification for human or animal consumption, were mixed with certain portions of the salt moving through the operations described in (1) and (2) above.

(g) The final operation, on a flow basis, moved the salt as to all grades, types and packs into trucks, railroad cars, barges or boats.

8. The basic pattern of plaintiff's production from its dry mining operation (rock salt) was as follows:

(a) Rock salt was mined in essentially the same manner as is coal, by undercutting, drilling, and blasting.

(b) After the initial extraction operation, rock salt went through a crushing process, either in the mine or above ground, or both.

(c) Following the crushing process, the rock salt was run through screens, after which the fine grade was kiln dried, except for the amounts hereinafter indicated which were shipped in bulk form.

(d) Thereafter, additives were mixed with certain portions of the salt, for the purpose of either enhancing the free running qualities of the salt or providing food fortification for human or animal consumption, and some of the straight screen grades, either with or without additives, were shipped in bulk form while the balance was flowed into hydraulic presses and other types of compression equipment for the production of blocks or into the package line.

(e) The final operation, on a flow basis, moved the salt as to all grades, types and packs into trucks, railroad cars, barges or boats.

9. From the time the brine leaves the bottom of the well

in the hydraulic mining operation, or from the time the rock salt leaves the face of the mine in the dry mining operation, until the final loading operation is completed, there is no chemical change in plaintiff's product. Regardless of the ultimate type of crystal formation, screen size, grade or pack, the product starts out as sodium chloride and at all stages remains sodium chloride.

10. Plaintiff's crude extraction product, in the case of hydraulic mining, was salt brine at the wellhead and, in the case of dry mining, was the mining muck pile immediately after blasting. During the years herein involved, plaintiff never sold any brine at the wellhead nor any rock salt from the muck pile. The product was always processed before sale. However, commencing in 1958, plaintiff did sell brine from a plant at Odessa, Texas. Such sales, amounting to approximately 10,000–11,000 tons annually, were made for approximately $6.50 a ton on a dry salt basis. Generally, saturated brine contains approximately 23 percent salt. The plant resulted from the operations of a natural gas company (the El Paso Natural Gas Company) which was developing cavities in the salt strata at that location for the storage of gas. Having no place to dump the brine, plaintiff arranged with the company to take over the installation since plaintiff had two customers located around 1½ miles from the salt cavity who were jointly engaged in the production of butadiene rubber products, and in connection therewith could use the brine. All of the brine from this plant of plaintiff's was sold to these two customers. The salt in place is owned by the natural gas company and the brine is conveyed by plaintiff by pipeline. The only other location from which plaintiff presently sells brine is near Windsor, Ontario. Here, the brine is transported by pipeline to a customer in Detroit, Michigan, which uses it in the production of soda ash. The production, sale and delivery of this brine from Ontario also commenced in 1958. All the brine

sold from this plant, consisting of approximately 750,000 tons annually, goes to this one customer (the Solvay Division of Allied Chemical Company). Plaintiff's general salt mining operations in Canada, which commenced in 1952, are conducted through a subsidiary company.

11. The salt produced by plaintiff during the years herein involved consisted of three basic types; i.e., evaporated granulated salt, evaporated flake or grainer salt, and rock salt. Evaporated granulated salt and evaporated flake or grainer salt were produced in the hydraulic mining operation and the rock salt in the dry mining operation. The treatment processes applied at plaintiff's plants to produce plaintiff's salt products with respect to each of the three basic types of salt were as follows:

Evaporated granulated salt		Evaporated flake or grainer salt		Rock salt	
Stage	Process	Stage	Process	Stage	Process
1	Underground brining and pump lift at wells.	1	Underground brining and pump lift at wells.	1	Undercutting, drilling and blasting.
2	Treatment to remove brine impurities.	2	Treatment to remove brine impurities.	2	Underground conveying.
3	Vacuum pan evaporation.	3	Open pan and flash evaporation.	3	Through grizzly and primary crusher (underground).
4	De-watering.	4	De-watering.	4	Conveying and hoisting.
5	Kiln drying.	5	Kiln drying.	5	Scavenger screening.
6	Screening.	6	Screening.	6	Grinding.
7	Introduction of additives where required.	7	Introduction of additives where required.	7	Screening.
8	Bulk loading.	8	Bulk loading.	8	Kiln drying (fine grades per seasonal requirements).
9	Packaging and block presses.	9	Packaging.	9	Introduction or additives where required.
10	Package loading.	10	Package loading.	10	Bulk loading.
				11	Packaging and block presses.
				12	Package loading.

During the years involved herein, plaintiff produced evaporated granulated salt at its plants at Silver Springs, New York; Rittman, Ohio; Port Huron, Michigan; Manistee, Michigan; Hutchinson, Kansas; Weeks Island, Louisiana; and Grand Saline, Texas, and it produced evaporated flake salt at its plants at Silver Springs, New York; Rittman, Ohio; Port Huron, Michigan; Manistee, Michigan; Hutchinson, Kansas; and Grand Saline, Texas.

12. Plaintiff's production operations for all three types of salt constitute a gravity propelled continuous flow, closed circuit operation. In the case of evaporated granulated salt and evaporated flake or grainer salt, little salt escaped the circuit until stage 8 (bulk loading) was reached. There was, however, some tonnage sold between stage 4 (de-watering) and stage 5 (kiln drying), the amount so sold being hereinafter set forth. In the case of rock salt, very small tonnages (hereinafter set forth) were shipped on an infrequent basis between stage 4 (conveying and hoisting) and stage 5 (scavenger screening), but no appreciable tonnages escaped the circuit until stage 10 was reached.

13. Evaporated granulated salt is produced from brine which passes through vacuum pans. The crystals are cube-shaped and relatively small. Plaintiff produces an extra pure evaporated granulated salt, which is 99.9 percent NaCl (sodium chloride) and is identified by plaintiff for marketing purposes as "999." This high purity granulated salt is produced by exactly the same treatment processes as evaporated granulated except for an additional chemical treatment just after stage 2 to remove certain "impurities" inherently attached to the salt crystals. This extra pure salt is sold for use in products that would be adversely affected by the presence of such "impurities." Evaporated flake or grainer salt is produced from brine which passes through open-grainer pans. The resulting crystal aggregates are flake-shaped and medium in relative size. Rock salt consists

of cube-shaped crystals which have been knit together in a solid formation by natural conditions. The crystals produced are relatively coarse.

14. (a). In the case of granulated and flake salt, the chemical treatment at or just subsequent to the brine well stage (stage 2) was for the sole purpose of inhibiting or removing certain "impurities" so as to make the brine more readily usable in the operational processes of the plaintiff. In no instance was the aforesaid chemical treatment employed for the purpose of producing, by chemical changes, additional salt, nor was the result of such chemical treatment the production of additional salt, although minute quantities of additional sodium chloride may have been produced incidentally where either magnesium chloride or calcium chloride was one of the "impurities" sought to be removed. The treatment variations between the several plants of the plaintiff were due to the difference in the "impurities" present in the salt at the various locations.

(b) The processes adopted to free the salt from impurities at later stages vary. The salt crystals in themselves do not contain impurities. The impurities are other substances which physically adhere to the salt crystals. These processes result in freeing the impurities from the crystals. This is a physical and not a chemical process. A number of impurities may be removed by simply washing the salt in plain water. Others may be removed in the mechanical process of crushing and screening. The larger the screen size, the less pure the product will be, since during the screening process some impurities fall away.

15. Stage 6 (screening) for granulated and flake salt and stage 7 (screening) for rock salt reflect a physical segregation of salt crystals into various sizes by the use of screens having different meshes. The resulting grades of salt sold by plaintiff were as follows:

Type	Through screen size	Grade	Bulk	Package	Compressed
Evaporated granulated	10 Mesh	K.D. Granulated*	X	X	X
		"999"	X	X	
	10 on 24 M	Coarse		X	
	24 on 66 M	Table	X	X	
	66 M	Extra fine		X	
	200 M	200 Mesh		X	
Evaporated flake	8 Mesh	Medium Flake	X	X	
	8 on 16 M	Extra Coarse Flake		X	
	8 on 24 M	Coarse Flake		X	
	24 M	Fine Flake		X	
	24 on 66 M	H. G. Flake*		X	
	24 on 40 M	Special Flake		X	
	40 on 66 M	Special Fine Flake		X	
	66 M	Extra Fine Flake		X	
Rock	1½ Mesh	#2 Grade and smaller	X		
	1½ on 2 M	#2 Grade	X	X	
	2 on 3½ M	#1 Grade	X	X	
	3½ on 5 M	"A" Grade	X	X	
	5 M	"C" Grade and smaller	X	X	
	5 on 10 M	"C" Grade	X	X	
	10 on 18 M	Kleer Granulated	X	X	X
	18 on 24 M	Kleer Fine	X	X	X
	24 on 66 M	Kleer Table		X	
	66 M	Dust		X	

*"K.D." means "Kiln Dried" and "H.G." means "High Grade."
"X" means product sold in indicated form.

The rest of the industry's dry salt producers used substantially the same screen sizes to produce comparable grades of salt.

16. The various screen grades of dry salt have evolved as a result of the different demands of the various customers for salt. Where the difference in characteristics among the types and grades in respect of chemical purity, rate of solubility, evenness of distribution, adhesiveness, or hardness or softness of crystal structure, is important to the customer, the particular type and grade that satisfies the customer's requirements is demanded. For example, a relatively coarse grade of rock salt is demanded for ice control on highways, because of the particular characteristics of that type of salt; coarse flake or fine flake salt is insisted upon by buttermakers because it provides the proper rate of

solubility; and extra pure K. D. granulated ("999") salt is required by a chemical company which produces metallic sodium through an electrolysis process. Each type of salt has characteristics which differ from the other two types. Within each type the screening process segregates grades by crystal sizes which perform in different ways depending upon the customer's use.

17. Of the various grades of salt produced and sold by plaintiff, some were sold without additives in bulk, some without additives in packages, some with only product quality additives in bulk, some with only product quality additives in packages, some only in packages, some with additives for specific customer requirements in bulk, and some in compressed form.

18. At stage 7 for granulated and flake salt and at stage 9 for rock salt, plaintiff mixed certain additives with certain portions of its tonnage. Certain of these additives were employed to meet certain specific customer requirements for the salt products, such as food fortification for animals, the use of iodine for the minimization of endemic goitre in humans, and the reduction of corrosiveness. The cost of these additives was as follows:

Year	Cost of additives for specific customer requirements
1954	$229,075
1953	597,609
1952	508,590
1951	436,624

The remainder of the additives was employed for the sole purpose of imparting general usable qualities to the salt, such as free running quality and the reduction of caking. The cost of these additives was as follows:

Year	Cost of general product quality additives
1954	$400,864
1953	312,464
1952	315,733
1951	343,217

The use of an additive does not necessarily increase the cost of the salt to the purchaser. There has, for instance, never been an extra charge for iodized table salt. Plaintiff began adding iodine to table salt in 1924 at the behest of the Michigan Medical Association, which had decided that salt was the best means by which iodine could be administered to prevent endemic goiter in humans. Federal and state agricultural experts decided that salt was the best vehicle for administering trace minerals to animals and educational efforts among farmers caused a demand for trace mineralized salt. The various producers of dry salt use similar additives for similar purposes.

19. The cost of mixing additives for specific customer requirements was as follows:

Year	Cost of mixing additives for specific customer requirements
1954	$78,500
1953	169,830
1952	163,712
1951	140,969

The cost of mixing general product quality additives was as follows:

Year	Cost of mixing general product quality additives
1954	$177,786
1953	88,975
1952	101,666
1951	110,851

20. Plaintiff purchased all its packaging material from outside sources in the years 1951, 1952 and 1953. In 1954, at its Port Huron, Michigan, and Rittman, Ohio, plants, plaintiff began making its own 26-ounce round cans as a part of its continuous packaging process. In addition to the industry standard 26-ounce round can for table salt, plaintiff began in 1952 to pack table salt in 4-ounce "miniatures" and in 1954 it added 4-ounce "salters."

21. With respect to salt sold for human consumption, plaintiff was required by the Federal Pure Food and Drug Act to label its product, making full disclosure of the product's contents, and, in order to comply, plaintiff was obliged to package all salt sold directly for human consumption. Most grades of rock salt and some grades of evaporated salt are not marketable for human consumption. With respect to salt with additives sold directly for animal consumption, plaintiff was required by the laws of 42 states to register, and, pursuant thereto, properly to package and label such salt sold for animal consumption. In addition, packaging is essential to protect salt for edible uses against contamination.

22. With respect to salt sold for other than direct human or animal consumption, salt was packaged to facilitate its handling without damage and to protect it against contamination. Buyers of salt for ice control on streets have no particular requirements as to chemical purity whereas a chemical company producing metallic sodium by the electrolysis process can entertain no impurity tolerance. The users of "C" grade rock salt permit a reasonably wide flexibility as to screen size whereas the producers of self-rising flour must have salt of a screen size very similar to the flour to avoid a fatal separation of product ingredients. Such a user must have a fine screen grade that is protected from contamination and caking by packaging.

It is practically impossible to contain physically the fine grades of salt long enough to move them from plant to customer unless they are packaged. Where solubility is important to the user such as in the making of butter, only certain grades of flake salt are satisfactory. Where the characteristic of evenness of distribution is of paramount importance to a user such as a cheesemaker, only a grade of flake salt is acceptable. Packaging of these grades is essential to preserve the desired physical characteristics. The producer of animal feeds requires salt with some moisture content for reasons of admixture with other feed materials, whereas pigment manufacturers require salt that is bone dry. Packaging is necessary to protect against the moist salt caking and the dry salt attracting moisture.

23. At all times plaintiff produced and sold in bulk form as much salt as it was able to sell in that form. At no time has any producer of dry salt ever operated at full 24 hours a day plant capacity. The demand for bulk salt is highly seasonal because of the quantities used in ice control. Package material adds nothing to the inherent quality of the salt product; it preserves for and communicates to the customer the desired qualities achieved at plaintiff's plant and is discarded when the salt is used. Many customers who might be able to accept salt in bulk form insofar as quality characteristics are concerned insist on packaged salt because they lack facilities for storage or handling of salt in bulk form. In those producing areas where the plaintiff lacked certain types and grades of production and therefore purchased such types and grades from other producers, it purchased bulk and packaged salt for resale in the same proportions and for the same reasons of customer demand as though it had produced those types and grades itself. Of the five screen grades of granulated salt, only two are able to be sold in bulk. Of the eight screen

size grades of flake salt, only one is able to be sold in bulk. Of the ten screen size grades of rock salt, two are unable to be sold in bulk.

24. There is a minimum of care used in loading salt in bulk. Salt shipped in bulk goes into cars, barges, ships and trucks by means of gravity through loading spouts or by the use of slingers, which are merely mechanical devices for throwing the salt into the transportation units, and those cars, barges, ships and trucks vary in their condition at the time of loading from fairly clean to very dirty. Some of the bulk moves in box cars, some in covered gondola cars and some in covered barges or ships, but the rest moves in open units as to which there is either no protection while in transit, or, at the most, a tarpaulin. At the other end of the line, if the customer takes a salt shipment in bulk form, he must have the mechanical equipment required to unload bulk and must be equally prepared to provide either a warehouse area or an open storage area for the reception of the salt.

25. One grade of granulated salt and two grades of rock salt were physically compressed by plaintiff through mechanical devices into 50-pound blocks, small bricks and spools, small egg-shaped pellets and small tablets. No flake salt was used for compressed items. The demand for blocks, bricks and spools arose because the farmers and ranchers wanted a salt product which could be used in open fields without dissolving as rapidly as large chunks of rock salt and which was smooth so as to avoid the injuries to mouths and tongues of livestock that had resulted from the rough, jagged edges of the rock salt. Pellets were designed to meet the requirements of the growing water softener industry for salt to be used in resin type softeners. Tablets are the result of the recommendations of the medical profession and the demands of the canning industry. In speci-

fying salt to prevent heat exhaustion in humans, doctors recommended tablets to insure proper dosage and to retard and control the dissolution rate in order to prevent nausea. With the advent of high-speed can lines, the canning industry demanded salt in tablet form which provided accurate salt measurement for each can and permitted the injection of salt at high speeds. Competing producers make the same compressed items.

26. The cost to plaintiff of package material with respect to salt sold to markets where packaging was required by law and with respect to salt sold to other markets was as follows:

Year	Cost of package material	
	For markets where packaging required by law	For other markets
1954	$6,380,618	$1,335,413
1953	6,486,834	1,434,213
1952	6,009,336	1,474,591
1951	5,712,816	1,504,317

27. The cost to plaintiff of filling and packing salt sold to markets where packaging was required by law and with respect to salt sold to other markets was as follows:

Year	Cost of filling and packing	
	For markets where packaging required by law	For other markets
1954	$1,341,614	$ 488,644
1953	1,199,252	539,817
1952	1,145,804	505,568
1951	1,044,309	527,884

28. The cost to plaintiff of the compression of salt into blocks, bricks, spools, pellets and tablets was as follows:

Year	Compression Costs
1954	$617,536
1953	663,000
1952	616,240
1951	494,600

29. In 1954, plaintiff had a total of approximately 30,000 customers who purchased plaintiff's salt products in bulk and package form as indicated:

	Tonnage	Percent of total tonnage	Number of customers	Percent of total customers	Gross income	Percent of total gross income
Package	948,785	63.25	28,500	95	$31,978,045	89.35
Bulk	551,065	36.75	1,500	5	3,810,743	10.65
	1,499,850	100.00	30,000	100	$35,788,788	100.00

Of plaintiff's bulk sales of all types of salt in 1954 to its 1,500 bulk salt customers, approximately 59 percent was made to 21 customers as follows:

Number of customers	Percent of bulk customers	Percent of total customers	Bulk tonnage purchased	Percent of total bulk tonnage
21	1.4	0.0007	325,000	58.9
1,479	98.6	4.9993	226,065	41.1
1,500	100.00	5.0000	551,065	100.0

Of the 21 customers for bulk salt, one used it for water softening and the other 20 used it either for hide curing or chemical operations. The only remaining principal use for bulk salt is in ice control for streets and highways.

30. The gross income ratios of plaintiff's sales of bulk and package salt were as follows:

Year	Total gross income	Bulk		Package	
		Gross income	Percent of total	Gross income	Percent of total
1954...	$35,788,788	$3,810,743	10.65	$31,978,045	89.35
1953...	34,912,092	3,827,001	10.96	31,085,091	89.04
1952...	32,437,082	3,462,287	10.70	28,974,795	89.30
1951...	32,195,289	3,467,433	10.77	28,727,856	89.23

In determining its gross income from its property on its income tax returns for each of the years 1951, 1952, 1953 and 1954, plaintiff deducted the amount of all (a) returns, (b) allowances, (c) freight, (d) warehouse charges, and (e) receipts from the sale of salt purchased from other salt producers, from its gross income from the sale of salt produced at its indicated plants, exclusive of Saltair, Utah. While there was generally no variation in the published f.o.b. plant list prices on the same type and grade of salt among plaintiff's plants or among the plants of other multiple plant producers, local price competition from time to time would reduce the net revenue return of a particular plant. Again, a local competitive situation requiring plaintiff to meet a price by means of a discount from the list price would affect only the portion of a plant's sales of a particular type and grade to customers located within a given geographical area. Plaintiff's f.o.b. plant list prices varied as between granulated salt, flake salt and rock salt at any given time because the costs to produce the three types of salt differ. Various factors, such as a barge company which moved salt back up the Mississippi River as a backhaul for grain shipments and itinerant truckers who avoided the regular rate structure, caused plaintiff to receive lower net revenues at particular plants in order to meet the competition of artificially low transportation costs.

31. (a) The total tonnage ratios of plaintiff's sales of bulk and package salt were as follows:

Year	Total tons	Bulk		Package	
		Tons	Percent of total	Tons	Percent of total
1954	1,499,850	551,065	36.74	948,785	63.26
1953	1,550,199	598,976	38.63	951,223	61.37
1952	1,490,837	500,236	33.55	990,601	66.45
1951	1,460,549	665,193	45.47	795,356	54.53

(b) The quantity of sales of salt in bulk differs in the varying areas of the United States, with salt in bulk form for ice control being sold principally in the Northern States and with sales in bulk form to the chemical industry varying between the areas where the chemical plants are located. The ratio of sales in bulk to sales in package form varies between the various plants of the plaintiff, with the variation depending upon whether or not a particular plant is in the area where the sales are made for ice control or for chemical use. For example, the ratio of sales in bulk is high at plaintiff's rock salt mine at Fairport, Ohio, whereas the package ratio is high at plaintiff's plant at Port Huron, Michigan.

32. (a) The tonnage ratios by types of salt of plaintiff's sales of bulk and package salt were as follows:

Year	Type of salt	Total tons	Bulk		Package	
			Tons	Percent of total	Tons	Percent of total
1954	Evaporated	1,000,159	269,436	26.93	730,723	73.07
	Rock	499,691	281,629	56.36	218,062	43.64
1953	Evaporated	1,059,769	303,018	28.59	756,751	71.41
	Rock	490,430	295,958	60.34	194,472	39.66
1952	Evaporated	1,023,411	239,637	23.41	783,774	76.59
	Rock	467,426	260,599	55.75	206,827	44.25
1951	Evaporated	1,032,859	413,426	40.02	619,433	59.98
	Rock	427,690	251,767	58.86	175,923	41.14

A higher ratio of rock salt is sold in bulk than is evaporated salt because many uses for rock salt are such that contamination and handling are not problems.

(b) The tonnage ratios by types of evaporated salt of plaintiff's sales of bulk and package salt were as follows for the years 1953 and 1954, no breakdown being available for the years 1951 and 1952:

Year	Type of salt	Total tons	Bulk		Package	
			Tons	Percent of total	Tons	Percent of total
1954	E. Granulated	903,461	256,436	28.38	647,025	71.62
	E. Flake	96,698	13,000	13.44	83,698	86.56
1953	E. Granulated	948,986	276,922	29.18	672,064	70.82
	E. Flake	110,783	26,096	23.55	84,687	76.45

33. Plaintiff's salt, with only the exceptions hereinafter noted, had to reach the eighth basic stage of extraction and processing for evaporated granulated salt and evaporated flake or grainer salt (stage 8) and the tenth stage for rock salt (stage 10) before a portion of it was sold. The exceptions were as follows:

(a) With respect to evaporated granulated and evaporated flake or grainer salt, the indicated tonnages were sold between stages 4 and 5, after the salt underground had been brined, pumped, purified and evaporated, and said tonnages compared with the total tonnages of evaporated salt sold as follows:

Year	Total tonnage of evaporated salt	Tonnage sold before stage 8	Percent of total
1954	1,000,159	40,895	4.08
1953	1,059,769	29,454	2.77
1952	(Data unavailable)	.....	.....
1951	(Data unavailable)	.....	.....

(b) With respect to rock salt, the indicated tonnages were sold at a point earlier than stage 10, after the rock salt from the muck pile had passed through the grizzly and primary crusher and the above ground surge bin, and said tonnages compared with the total tonnages of rock salt sold as follows:

Year	Total tonnage of rock salt	Tonnage sold before stage 10	Percent of total
1954	499,691	1,986	.39
1953	490,430	6,803	1.38
1952	467,426	7,722	1.65
1951	427,690	6,731	1.57

34. Several other companies produce and sell finished salt products in the same form as the plaintiff. For the years involved, four of these companies (International Salt Company, Diamond Crystal Salt Company, Carey Salt Company and Watkins Salt Company) sold large quantities of bulk salt in the various described types and amounts set forth in the following chart. In each case, the stage in which the amounts of salt were sold corresponds to the described stages contained in finding 11 above. The chart also sets forth the types and the amounts sold by these companies in such years in packaged form.

Type of salt pack	Total tons	1951 net sales	Price per ton [5]	Total tons	1952 net sales	Price per ton [5]	Total tons	1953 net sales	Price per ton [5]	Total tons	1954 net sales	Price per ton [5]
Bulk												
Stage #4:												
Granulated	.....	.....	....	10,919	[1] $63,925	$5.85	[1] 8,041	[1] $51,051	$6.35	[1] 7,896	[1] $53,623	$6.79
Flake	.....	.....	....	[1] 1,553	[1] 16,989	10.94	[1] 1,721	[1] 20,924	12.16	[1] 2,407	[1] 35,831	14.89
Stage #6:												
Granulated	.....	[2] 110,915	[2] $1,084,716	$9.78	[3] 97,550	[3] 963,761	9.88	[3] 100,155	[3] 1,055,041	10.53	[3] 103,458	[3] 1,141,025	11.03
Flake (grainer)	....	[2] 10,566	[2] 163,828	15.51	[3] 9,243	[3] 137,921	14.92	[3] 11,263	[3] 184,571	16.39	[3] 10,774	[3] 186,913	11.35
Stage #7:												
Rock	.....	[2] 2,296,516	[2] 10,565,164	4.60	[3] 2,515,677	[3] 11,561,660	4.60	[3] 2,473,705	[3] 11,200,563	4.53	[3] 2,642,524	[3] 13,293,180	5.03
Total	.....	[3] 2,758,598	[3] 15,145,776	....	[4] 2,626,470	[4] 12,663,342	....	[4] 2,647,303	[4] 13,004,241	....	[4] 2,822,052	[4] 14,614,177	....
Stage #7:												
Granulated	.....	.....	.....	....	[1] 2,158	[1] 20,026	9.28	[1] 2,007	[1] 19,449	9.69	[1] 2,014	[1] 19,554	9.71
Grand total bulk salt		[3] 2,758,598	[3] 15,145,776	....	[4] 2,639,615	[4] 12,786,183	....	[4] 2,661,441	[4] 13,116,882	....	[4] 2,836,584	[4] 14,655,680	....
Packaged												
Bags:												
100# Granulated	....	[1] 91,220	[1] 1,544,400	16.93	[2] 117,964	[2] 1,949,987	16.53	[2] 129,408	[2] 2,105,211	16.27	[2] 132,942	[2] 2,194,250	16.51
Flake	.....	[1] 169,440	[1] 3,735,000	22.04	[2] 179,762	[2] 3,828,345	21.30	[2] 193,765	[2] 4,044,359	20.87	[2] 194,287	[2] 4,017,502	20.64
Rock	.....	.....	.....	....	[2] 97,316	[2] 961,937	9.88	[2] 89,559	[2] 932,814	10.42	[2] 83,514	[2] 905,095	10.84
50# Granulated	....	[1] 960	[1] 19,100	19.90	[2] 1,481	[2] 39,295	26.53	[2] 1,758	[2] 46,675	26.55	[2] 1,831	[2] 52,874	28.88
Flake	.....	[1] 900	[1] 24,900	27.67	[2] 1,333	[2] 34,517	25.89	[2] 1,605	[2] 41,171	26.03	[2] 1,[illegible]076	[2] 55,723	26.85
Rock	.....	.....	.....	....	[2] 2,540	[2] 46,927	18.48	[2] 2,952	[2] 49,789	19.21	[2] 2,298	[2] 44,330	19.29
25# Granulated	....	[1] 1,630	[1] 40,100	24.60	[2] 2,922	[2] 68,463	23.43	[2] 2,892	[2] 68,091	23.5[illegible]	[2] 2,812	[2] 67,308	23.44
Flake	.....	[1] 860	[1] 31,400	36.51	[2] 1,101	[2] 37,172	33.76	[2] 1,187	[2] 39,547	33.3[illegible]	[2] 1,252	[2] 41,817	33.40
Rock	.....	.....	.....	....	[2] 4,000	[2] 90,064	22.52	[2] 3,469	[2] 79,835	23.02	[2] 3,158	[2] 73,594	23.30
10# Granulated	....	[1] 2,930	[1] 120,500	41.13	[2] 4,393	[2] 169,779	36.64	[2] 4,525	[2] 176,239	38.94	[2] 2,609	[2] 112,007	42.93
Flake	.....	[1] 670	[1] 27,000	40.30	[2] 1,279	[2] 51,908	40.58	[2] 1,268	[2] 54,400	42.90	[2] 1,299	[2] 56,806	43.73
Rock	.....	.....	.....	....	[2] 1,306	[2] 46,942	35.79	[2] 1,163	[2] 44,963	38.66	[2] 1,089	[2] 42,139	38.70
5# Granulated	.....	.....	.....	....	.....	.....	....	.....	.....	....	[2] 576	[2] 27,979	48.67
Rock	.....	.....	.....	....	.....	.....	....	.....	.....	....	[2] 232	[2] 10,548	45.47
4# Granulated	....	[1] 180	[1] 7,500	41.67	[2] 2,693	[2] 109,057	40.50	[2] 964	[2] 44,103	41.27	[2] 2,550	[2] 115,276	45.21
Flake	.....	[1] 1,460	[1] 60,000	41.10	[2] 1,849	[2] 76,395	41.32	[2] 1,461	[2] 66,408	45.21	[2] 1,300	[2] 64,610	49.70
Rock	.....	.....	.....	....	.....	.....	....	.....	.....	....	.....	.....	....

See footnotes at end of table.

Type of salt pack	Total tons	1951 net sales	Price per ton [5]	Total tons	1952 net sales	Price per ton [5]	Total tons	1953 net sales	Price per ton [5]	Total tons	1954 net sales	Price per ton [5]
Packaged—Continued												
Bags—Continued												
Total bags:												
Granulated	[3] 426,835	[3] 5,590,668	....	[3] 261,893	[3] 4,565,372	....	[3] 287,368	[3] 5,191,707	....	[3] 291,782	[3] 5,455,331	18.70
Flake	[3] 185,066	[3] 4,130,325	....	[3] 195,211	[3] 4,203,967	....	[3] 209,121	[3] 4,457,478	....	[2] 210,087	[2] 4,527,869	21.55
Rock	[3] 317,107	[3] 4,268,936	....	[2] 424,118	[2] 5,431,001	....	[2] 357,327	[2] 4,547,019	....	[2] 392,186	[2] 5,140,641	13.11
Compressed items:												
Granulated	[1] 8,170	[1] 149,480	23.23	[3] 105,631	[3] 1,770,496	16.82	[3] 78,243	[3] 1,676,779	21.43	[2] 53,290	[2] 1,270,379	22.90
Rock	[1] 15,434	[1] 358,500	18.30	[3] 21,673	[3] 411,062	18.97	[2] 20,964	[2] 431,631	20.59	[2] 17,284	[2] 392,877	22.73
Cartoned items:												
4# Square granulated	.....	.....	....	[2] 625	[2] 31,024	49.65	.....	.....	....	.....	.....	....
4# Square rock	.....	.....	....	.....	.....	....	[1] 38	[1] 1,710	45.00	[1] 18	[1] 985	54.72
3# Square												
Granulated	[1] 230	[1] 11,800	51.30	[2] 1,025	[2] 238,163	....	[2] 1,051	[2] 47,747	46.43	[2] 626	[2] 32,878	52.52
Flake	[1] 2,850	[1] 216,800	76.07	[1] 36	[1] 1,643	73.57	[1] 3,131	[1] 225,226	71.95	[2] 3,352	[2] 268,672	80.15
1.5# Square												
Granulated	[1] 520	[1] 27,300	52.50	[1] 364	[1] 15,450	42.45	[2] 900	[2] 43,634	48.48	[2] 902	[2] 49,432	54.80
Flake	.....	.....	....	.....	.....	....	.....	.....	....	.....	.....	....
Rock	.....	.....	....	[1] 3,317	[1] 116,993	35.27	[1] 3,013	[1] 115,491	38.33	[1] 1,915	[1] 90,897	47.47
26 oz. Round												
	[1] 3,950	[1] 330,700	83.72	[2] 9,075	[2] 725,449	79.93	[2] 9,633	[2] 769,394	79.87	[2] 8,540	[2] 739,950	86.65
Rock	.....	.....	....	[1] 3,587	[1] 224,664	62.63	[1] 3,638	[1] 249,942	68.70	[1] 3,913	[1] 286,961	73.34
	[1] 20,060	[1] 2,030,500	96.57	[1] 1,990	[1] 1,946,600	97.82	122,024	[1] 2,110,027	95.81	[1] 23,766	[1] 2,351,751	98.95
4 oz. Miniatures	.....	.....	....	.....	.....	....	[1] 2	[1] 3,575	1,787.50	[1] 2	[1] 2,859	1,429.50
Total contained items:												
Granulated	[2] 48,634	[2] $2,981,746	....	[3] 52,355	[3] $3,657,721	....	[3] 54,757	[3] $3,945,544	....	[2] 51,184	[3] $4,163,387	....
Flake	[2] 23,201	[2] 2,264,515	....	[3] 22,952	[3] 2,167,469	....	[3] 25,430	[3] 2,352,179	....	[3] 27,336	[3] 2,638,654	....
Rock	.....	.....	....	[3] 7,019	[3] 346,881	....	[1] 6,725	[1] 369,164	....	[2] 5,885	[2] 380,742	....
Total tons and sales of packaged salt	[4] 3,869,264	[4] 36,371,049	....	[4] 3,842,213	[4] 37,062,196	....	[4] 3,755,081	[4] 37,024,333	....	[4] 3,956,904	[4] 40,898,024	....

1 Data available for one company.
2 Data available for two companies.
3 Data available for three companies.
4 Data available for four companies.
5 Determined by dividing net sales by total tons.

35. Except for one small producer who sold brine within a limited plant radius and some rare inconsequential instances historically on the part of a very few other producers, no dry salt producer marketed salt immediately after the extraction stage during the years herein involved. Brine is at least 77 percent water and is transported only very short distances. Brine is produced principally by chemical companies for their own uses. Normally these chemical companies do not sell sodium chloride to others.

36. The producer referred to in finding 35 was the Texas Brine Company of Houston, Texas. For the years involved this company sold the following tonnages of salt, on a dry salt basis, and received the following amounts of gross income:

Fiscal year ended—	Total tons of dry salt contained in brine sold	Gros income	Price per ton
Feb. 28, 1951	52,544	$256,199	$4.8759
Feb. 28, 1952	59,407	285,558	4.8068
Feb. 28, 1953	76,739	274,142	3.5724
Feb. 28, 1954	91,617	272,277	2.9719
Feb. 28, 1955	112,225	329,605	2.9370

The company transports the brine by pipeline approximately 20 to 24 miles. The brine sold contained approximately 2.6 pounds of dry salt a gallon. Each gallon of brine weighs approximately 10 pounds at 60 degrees. The price per ton shown in the above chart was determined by dividing the gross income by total tons for each year. The customers of the company are as follows:

Major Accounts	*Other Accounts*
Goodyear Tire & Rubber Co.	General Tire & Rubber Co.
Champion Paper Co.	Carbide & Carbon Co.
Ethyl Corporation	Humble Oil & Refining Co.
	Monsanto Chemical Co.
	American Oil Co.
	Shell Chemical Co.
	Houston Light & Power Co.
	Sinclair Refining Co.
	Phillips Chemical Co.
	Distillate Products Co.

37. Sparta Oil Company, Houston, Texas, produces brine in connection with its oil operations and sells its entire brine output to Brine Service Company, f.o.b. Pierce Junction, Houston, Texas. The brine sold by Sparta Oil Company contained approximately 3.01 pounds of dry salt and 7.19 pounds of water, a total of 10.2 pounds. Each barrel of brine contained approximately 301.98 pounds of water and 126.42 pounds of dry salt, a total of approximately 428.40 pounds of brine. Each ton of brine contained approximately 15.82 barrels of brine. Information is not available for the years 1951 and 1952, but in 1953 and 1954 Sparta Oil Company produced and sold to Brine Service Company brine containing the tonnage of dry salt and for which it received gross income as follows:

Year	Total tons of dry salt contained in brine sold	Gross income	Price per ton
1953	11,854	$16,596	$1.40
1954	6,731	9,424	1.40

The price per ton shown above was determined by dividing the gross income by total tons for each year. Brine Service Company transported the brine by trucks from Pierce Junction, Houston, Texas, approximately 12 miles to its major customer, Goodyear Tire & Rubber Company, which purchased it at a delivered price amounting to an average of $3 a ton. Each tank truck of Brine Service Company carries approximately 100 barrels of brine.

38. The United States Department of the Interior, Bureau of Mines, publishes annually a Minerals Yearbook. A chapted from volume 1 of the 1954 yearbook, entitled "Salt," discusses salt production in the United States, its consumption and uses, salt prices during the year, imports and exports, advances in technology, and reviews salt pro-

duction throughout the world. Included therein (p. 1) is a chart setting forth certain data concerning domestic production of salt. Pertinent portions of this chart, together with the introductory comments concerning the chart, are as follows:

> THE TONNAGE of salt produced in the United States in 1954 was second only to the record reached in 1953. A decline in production of salt in brine more than offset slight gains in evaporated and rock salt during the year, so the total salt output in 1954 was less than 1 percent lower than in 1953:

TABLE 1.—*Salient statistics of the salt industry in the United States, * * * [1951]-1954*

Sold or used by producers	1951	1952	1953	1954
Dry Salt:				
Evaporated (manufactured) ..short tons	3,654,808	3,641,885	3,702,305	3,731,087
Rock salt ....do....	4,662,194	4,567,531	4,478,655	4,824,708
Total ....do....	8,317,002	8,209,416	8,180,960	8,555,795
Value	$58,425,022	$59,757,322	$65,407,021	$73,405,661
Average per ton ...	$7.02	$7.28	$7.99	$8.58
In brine:				
Short tons	11,890,129	11,335,798	12,608,043	12,113,608
Value	$11,309,978	$11,252,767	$12,869,646	$32,180,276
Total salt:				
Short tons	20,207,131	19,545,214	20,789,003	20,669,403
Value	$69,735,000	$71,010,089	$78,276,667	$105,585,892

It is also stated therein:

CONSUMPTION AND USES

> Salt is an essential article of diet, but only a small percentage of the total salt consumed was used in this way. By far the greatest use of salt was in the production of soda ash (sodium carbonate), which in turn had a multitude of uses. Large quantities of salt also were utilized in manufacturing chlorine, bleaches, and other chemicals, as well as in water treatment, meat packing, feed mixing, and the many other categories listed in table 7 [omitted]. (pp. 2-3)

PRICES

According to Oil, Paint and Drug Reporter prices of rock salt and table salt were steady throughout the year. Rock salt in bags, carlots, works, was quoted at $0.98 per hundred pounds and table salt (vacuum common), same basis, was quoted at $1.12 per hundred pounds. The average value of dry salt reported by producers to the Bureau of Mines increased from $7.99 in 1953 to $8.58 in 1954. The average value reported for salt in brine rose sharply from just under $1 per ton in the preceding 5 year period to $2.66 per ton in 1954. This did not indicate a major increase in brine-salt prices but reflected primarily a change in reporting practice. Because much of the salt produced as brine was consumed by the producing companies, relatively few sales transactions occurred. Heretofore, values assigned by many producers have been far below market value. In the 1954 canvass a general effort was made to obtain reasonable local market valuations for salt in brine. Consequently, the average value for 1954 was much higher than for the previous year. (pp. 5-6)

39. The processes following the extraction of brine to reach evaporated granulated or flake salt by the hydraulic mining method are referred to in the salt industry as refining processes. As shown by the data compiled by the Bureau of Mines, set forth in finding 38, the term "manufactured" is also sometimes used to describe such processes in the production of evaporated dry salt. As hereinabove shown, there is no change in the chemical composition of salt effected as a result of such refining processes.

40. The processes employed by plaintiff in its various facilities with respect to the production of rock salt, evaporated granulated salt and evaporated flake or grainer salt were, with only minor and inconsequential deviations, identical with those employed by all other members of the salt industry. There have been few, if any, patents or secret

methods extant in the salt industry with respect to the processes for producing commercially marketable salt. Hence, as a matter of history in the industry, all processes have been available to and known by all members of the industry, with the result that processes in the salt industry have been as nearly standardized as those in any industry in the country. However, throughout the industry there are some differentials in the NaCl purity percentages between rock and evaporated salt, and there are some purity differentials within the separate rock and evaporated salt categories themselves which accordingly necessitated slightly different treatments for the elimination of "impurities." There has been no basic change in the production processes of dry salt for over 50 years. Plaintiff employs the same processes at all plants for the same types of salt. No producer of dry salt employs any process not employed by the plaintiff and plaintiff employs no processes not employed by other producers of dry salt. With only inconsequential exceptions relating to packaging and labeling, no one other than a dry salt producer has ever performed any of the individual processes involved in the various stages of producing salt described in finding 11.

41. The principal producers of dry salt produced and sold the types of salt as indicated by an "X" as follows:

Company	Type		
	Granulated	Flake	Rock
Morton	X	X	X
International	X	X	X
Jefferson Island	X	X	X
Carey	X	X	X
Diamond Crystal	X	X	...
Watkins	X	X	...
Hardy	X	X	...
Barton	X	X	...
Gordy	X	...	...
United	X	...	X
Michigan	X	...	...

On a tonnage basis, the smaller producers sold a higher percentage of their total production of salt in packaged form than did the producers of larger tonnages of salt. No producer has ever operated a plant for the production of salt to be sold only in bulk. The types of packs and package material used in packaging dry salt are standard in the industry.

42. The requirements of salt purchasers, except only for some variations between trade areas in the country, were and are highly standardized so that all members of the salt industry were and are confronted with similar markets. However, among salt purchasers there was and is a wide variation in quality requirements. Salt has a very large number of uses ranging over a wide variety of products and services with thousands of direct and indirect applications.

43. During the years herein involved, plaintiff sold salt in all the then 48 states. As salt is a heavy, cheap commodity, the cost to transport it is relatively high as compared to the f.o.b. plant price of the salt. In certain instances, the cost of transportation has been the substantial part of the total invoice price. The distance that salt can be economically transported is directly related to the cost of transportation. As a result, local markets exist for the sale of salt, which markets are centered around the producing areas of New York, Ohio, Michigan, Kansas, Louisiana, and Texas. Rail transportation being the predominant type of transportation of salt, rail rates basically determine the cost of transportation used by the dry salt industry. Salt receives a commodity rate which is a percentage of the class rate. The percentage of the class rate for shipment in package form is 22½ percent and for shipments in bulk form it is 17½ percent, but the minimum loading requirement for shipment in bulk form is 40 tons per car, whereas

for shipments in package form the minimum is 22½ tons per car. The reason for the differential is that salt shipments in packages would be damaged under excessive loading conditions. The fact that the salt is packaged, contains additives, or is compressed, does not affect its commodity designation as salt. Other producers of dry salt have plants in only certain of the producing areas and participate only in the respective markets.

44. In order to obtain maximum sales of the dry salt products that are produced by the salt producers, each must be able to furnish a full line of such products to customers to permit making up units of distribution such as carloads, barge loads and truck loads. Each producer either produces a full line or purchases from another producer the products that it does not produce. For example, because plaintiff did not have an available rock salt supply to meet the demands of its customers east of Ohio and in the eastern seaboard states, it opened a mine at Fairport, Ohio, in 1958.

45. In the sense that those members of the salt industry, such as plaintiff, who sell all or substantially all of their entire production as dry salt and do not themselves use salt in any form in connection with the production of other products, such as canned goods, paint pigments, butter or animal feed, they are nonintegrated companies. Similarly, in the sense that certain companies, such as chemical companies producing chlorine or soda ash, operate their own salt mines and extract salt therefrom in brine form, using the entire production thereof for their own purposes (referred to as a "captive" operation), they are to such degree integrated companies. The terms "integrated" and "nonintegrated" are frequently so used in a technical sense in the accounting profession as well as in the professional business analysis or management consultant field.

46. An accepted sense in which the term "constructive income" is technically employed by the accounting profession is to describe a situation in which the right to income has been earned and is, though the receipt thereof is deferred, legally entitled to be converted on some future date into liquid funds. In that accounting sense as applied to plaintiff's operation, plaintiff, in its closed circuit hydraulic gravity mining operation for the production of dry granulated or grainer salt, did not, during the years herein involved, have constructive income at the point at which the brine was produced at the wellhead. As shown, the points at which plaintiff's sales occurred in the tax years herein involved were beyond such wellhead stage of production and at levels at which the product had reached the dry granulated or grainer stages.

The term is not used for external financial reporting or internal accounting purposes by nonintegrated companies as defined above. It is, however, occasionally used for purposes of internal controls by integrated companies as herein defined.

(b) Similarly, in the case of a nonintegrated company such as is described in (a) above, an accepted sense in which the term "market value" is technically employed by the accounting profession would be the amount resulting from gross income from sales of the dry salt in its various end forms, less returns, allowances, and transportation, which the accountant would refer to as the amount resulting from "net sales," and which amount, depending upon a variety of factors, may or may not result in a "profit" to the individual producer. In plaintiff's case, this would be the sales prices of plaintiff's various dry salt products on board transportation units f.o.b. its plants. It is at such point that plaintiff's sales, whether in bulk or packaged (or boxed or bagged) form, give rise to "accounts receivable"

in said technical accounting sense. Consequently, in connection with plaintiff's operations, it was not considered from a technical accounting standpoint as having any constructive income prior to the point at which its products were sold and accounts receivable established therefor on its books.

(e) The term "value in place" in the case of minerals is, in the accounting profession, a term used to evaluate the minerals wherever they happen to be located in the form in which they are found. From the accounting standpoint, such value in place is normally determined on the basis of projecting the future "market value" as hereinabove defined and then discounting such value to the present date.

47. In the course of auditing plaintiff's income tax and excess profits tax returns for the years 1951, 1952 and 1953 and plaintiff's income tax return for 1954, the Internal Revenue agents recommended the disallowance of a portion of the depletion claimed by plaintiff for each of said years and deficiencies were determined and assessed against the plaintiff by the defendant as follows:

Year	Deficiency attributable to difference in depletion basis	Deficiency attributable to excess profits credit adjustment	Total deficiency
1951	$1,081,544.28	.....	$1,081,544.28
1952	1,016,606.08	$38,935.59	1,055,541.67
1953	1,081,004.10	76,935.09	1,157,939.19
1954	1,363,949.04	.....	1,363,949.04

48. On July 29, 1955, plaintiff paid to the defendant the sum of $3,789,537.58, of which the sum of $3,759,367.60 represented the amount of the deficiencies assessed as afore-

said for the years 1951, 1952 and 1953, together with interest, computed as follows:

Year	Deficiency	Interest	Total
1951.....	$1,081,544.28	$218,797.88	$1,300,342.16
1952.....	1,055,541.07	150,205.02	1,205,746.69
1953.....	1,157,939.19	95,339.56	1,253,278.75
	3,295,025.14	464,342.46	3,759,367.60

49. On August 28, 1957, plaintiff paid to defendant the sum of $1,366,143.18 of which the sum of $1,363,949.04 represented the amount of the deficiency assessed as aforesaid for the year 1954, together with an additional uncontested deficiency assessment in the sum of $60,118.82, plus interest and less credit for overassessments, computed as follows:

Deficiency attributable to difference in depletion basis	Additional deficiency	Interest	Total overassessments	Total
$1,363,949.04	$60,118.82	$83,479.78	($141,398.46)	$1,366,143.18

50. The overassessments in the total amount of $141,398.46, referred to in finding 49, were credited by defendant as of March 8, 1956, against the said deficiency assessed against plaintiff as described above. Interest for the period from March 15, 1955, the due date for the payment of plaintiff's 1954 income tax, to March 8, 1956, on said uncontested deficiency assessed in the amount of $60,118.82 equals $3,523.94, so that the uncontested deficiency and interest thereon total $63,642.76. The sum of $141,398.46 less said amount of $63,642.76 equals $77,755.70.

51. The disallowance by the Internal Revenue agents of a portion of the depletion deduction claimed by plaintiff for the years in question and the subsequent deficiency computations, all as described above, were based upon a depletion

base determined, according to the examining Internal Revenue agents, as follows:

(a) Direct cost centers are segregated to allowable and unallowable processes at producing plants. Allowable includes the cost of production from the well or mine through drying and screening. Unallowable includes all operations beyond the dried, screened stage.

(b) Indirect costs are spread to each activity on the percentage of direct cost, and then, at each plant eligible for depletion, the amount is allocated between allowable and unallowable processing.

(c) Inasmuch as there are salt tonnages sold by each plant in bulk, these sales were segregated. Included here as bulk "sales" are tonnages which were shipped from plant to warehouse, or plant to plant, and largely packaged at the latter points. These are recorded on company books as "transfers" and sales (bulk or packaged), are credited back to the shipping plant. Herein, these intercompany transfers are considered sales of bulk at the same value indicated by customers sales. It should be noted that in 1952 and 1953, records of these bulk sales and transfers were kept on the basis of sales or transfer value exclusive of freight. However, these amounts included freight. Therefore, the value ton indicated in 1952 was used in 1951. No discrepancy is indicated owing to the fact that the OPS prices established in 1950 existed until 1953. The cost of production on salt sold or transferred in bulk is established by multiplying tonnage (air dried or kiln dried grainer or vacuum pan) times applicable cost/ton. To this was added bulk loading cost. (In 1953 the latter cost was identified; in 1951 and 1952, it has been built up on the 1953 cost/ton.)

(d) After segregation of income and costs applicable to bulk salt sales and transfers, all other, i.e., processed, salt is considered for depletion by segregation of cost between allowable processing and manufacturing. The allowable processing cost of salt sold other

than plain bulk is the total allowable direct cost less than [sic] applicable to bulk sales. All other direct plant costs are considered to be manufacturing (or unallowable). As previously stated, each of these two categories of cost on processed salt takes its aliquot portion of indirect expense. The total cost (direct and indirect) to the bulk stage then receives its proportion of the income from processed salt as depletable gross income.

52. On March 30, 1956, plaintiff duly filed separate claims for refund of Federal income and excess profits taxes paid by plaintiff for each of the years 1951, 1952 and 1953 as the result of the deficiencies assessed with respect to percentage depletion deductions claimed by plaintiff. On March 20, 1958, plaintiff duly filed a claim for refund of Federal income taxes paid by plaintiff for the year 1954 as the result of the deficiency assessed with respect to the percentage depletion deduction claimed by plaintiff. These claims asserted that plaintiff had applied the depletion percentage for sodium chloride to its net sales of all its salt products to determine its depletion allowance and that the auditing agent of the Internal Revenue Service applied a different formula, thereby erroneously reducing plaintiff's percentage depletion allowance. No final action on these claims for refund has been taken.

53. On December 16, 1955, plaintiff duly filed separate claims for refund of Federal income and excess profits taxes paid by plaintiff for each of the years 1951, 1952 and 1953 as the result of deficiencies assessed with respect to amounts received by plaintiff in excess of cost upon the sales of shares of its treasury stock to its employees. Plaintiff duly filed a claim for refund of Federal income taxes paid by plaintiff for the year 1954 as the result of the erroneous failure to reduce long-term capital gain by the amount of capital loss carryover from the years 1952 and

1953. No final action on these claims for refund has been taken.

54. On March 20, 1958, plaintiff duly filed a claim for refund of Federal income taxes paid by plaintiff for the year 1954 as a result of erroneous additional interest assessed on the deficiency assessed with respect to the percentage depletion deduction claimed by plaintiff. No final action on this claim for refund has been taken.

55. The matters referred to in finding 53 are the subject of Count II of the petition herein, as supplemented by the "first supplement" thereto. The matters referred to in finding 54 are the subject of Count IV of said first supplement. By a stipulation filed June 13, 1960, the parties agreed that (1) with respect to the allegations contained in said Count II, plaintiff is entitled to recover the amount of the deficiencies paid, together with interest thereon as provided by law, and (2) with respect to the allegations contained in said Count IV, plaintiff is entitled to recover an amount equal to 67½ percent of the amount of the deficiency paid as set forth in Count IV, together with interest thereon as provided by law.

As a result of this stipulation, there remains for decision by the court only the issue concerning the correct basis upon which to compute plaintiff's allowance for percentage depletion, which issue is the subject of Counts I and III of said petition as supplemented by said first supplement.

56. The parties have, by stipulation filed herein on May 20, 1960, agreed that the remaining basic issue involved in this case for disposition by the court is the proper determination of plaintiff's basis for percentage depletion under sections 23(m) and 114(b) (4) of the Internal Revenue Code of 1939, as amended, with respect to the years 1951, 1952 and 1953 and under section 613 of the Internal Reve-

nue Code of 1954, as amended, with respect to the year 1954. As to this issue, the parties have pursuant to Rule 38(c), further stipulated, with the approval of the commissioner, that the trial would be limited to the issues of law and fact relating to the right of plaintiff to recover, reserving the determination of the amount of recovery, if any, for further proceedings.

CONCLUSION OF LAW

Upon the foregoing findings of fact, which are made a part of the judgment herein, the court concludes as a matter of law that plaintiff is entitled to recover on Counts II and IV of the petition, and judgment will be entered to that effect. The amount of recovery will be determined pursuant to Rule 38(c) of the Rules of this court.

Plaintiff is not entitled to recover with respect to Counts I and III, and that portion of its petition is dismissed.

APPENDIX C

SUPREME COURT OF THE UNITED STATES

No. 513.—October Term, 1959.

United States of America, Petitioner, v. Cannelton Sewer Pipe Company.	On Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit.

Decided June 27, 1960.

Mr. Justice Clark delivered the opinion of the Court.

This income tax refund suit involves the statutory percentage depletion allowance to which respondent, an integrated miner-manufacturer of burnt clay products from fire clay and shale, is entitled under the Internal Revenue Code of 1939.[1]

The percentage granted by the statute is on respondent's "gross income from mining." It defines "mining" to include the "ordinary treatment processes normally applied by mine owners . . . to obtain the commercially marketable mineral product or products." Respondent claimed that its first "commercially marketable mineral product" is sewer pipe and other vitrified articles. Alternatively, it contended that depletion should be based on the price of

[1] The applicable provisions of the Code are § 23(m) and § 114 (b)(4). In general, they provide for a depletion allowance based on a percentage of "gross income from mining," which is specifically defined. See note 8, *infra*. The percentage permitted on shale is 5%, and on fire clay, 15%.

80 tons of ground fire clay and shale actually sold during the tax year in question. The District Court agreed with respondent's first claim. The Court of Appeals affirmed, holding that respondent could not profitably sell its raw fire clay and shale without processing it into finished products, and that its statutory percentage depletion was therefore properly based on its gross sales of the latter. 268 F. 334. The Government contends that the product from which "gross income from mining" is computed is an industry-wide test and cannot be reduced to a particular operation that a taxpayer might find profitable. The Government further argues that, while the statute permits ordinary treatment processes normally applied by miners to the raw product of their mines to produce a commercially marketable mineral product, it does not embrace the fabrication of the mineral product into finished articles. In view of the importance of the question to taxpayers as well as to the Government, we granted certiorari, 361 U. S. 923. We disagree with respondent's contention that the issue is not presented by this record, and we therefore reach the merits. We have concluded that, under the mandate of the statute, respondent's "gross income from mining" under the findings here is the value of its raw fire clay and shale, after the application of the ordinary treatment processes normally applied by nonintegrated miners engaged in the recovery of those minerals.[2]

I.

During the tax year ending November 30, 1951, the respondent owned and operated an underground mine from which it produced fire clay and shale in proportions of 60%

[2] The quality of ground and bagged fire clay and shale actually sold is too negligible to furnish an appropriate basis for computing depletion.

fire clay and 40% shale. It transported the raw mineral product by truck to its plant at Canrelton, Indiana, about one and one-half miles distant. There it processed and fabricated the fire clay and shale into vitrified sewer pipe, flue lining and related products. In this process, the clay and shale is first ground into a pulverized form about as fine as talcum powder. The powder is then mixed with water in a pug mill and becomes a plastic mass, which is formed by machines into the shape of the finished ware desired. The ware is then placed in dryers where heat of less than 212° is applied to remove all of the water. This process takes from 12 hours to 3 weeks, depending on the size of the ware. Thereafter the ware is vitrified in kilns at 2,200° Fahrenheit requiring from 60 to 210 hours. It is then cooled, graded and either shipped or stored.

Not all clays and shales are suitable for respondent's operations. They must have plasticity, special drying qualities and be able to withstand high temperatures. Respondent's clay known as Cannelton clay, is the deepest clay mined in Indiana and, respondent says, yields the best sewer pipe. Its cost of removing and delivering the same to its plant was $2.418 per ton in 1951. Respondent used some 38,473 tons of clay and shale in its operations that year and sold approximately 80 tons of ground fire clay and shale in bags at a price of $22.88 per ton. Net sales of its finished wares amounted to approximately one and a half million dollars.

In connection with its tax assessment for the year in question, respondent filed a document in which it stated that "we used as a basis for calculating the gross income from our mining operations of shale and fire clay the point in our manufacturing operations at which we first arrive with a commercially marketable product, which is ground fire clay. This product arrives after the raw mineral is

crushed and granulated to such extent that by the addition of water it can be made into a mortar for use in laying or setting fire or refractory brick. This ground fire clay has a definite market and an ascertainable market value at any particular time and is the same product from which our end product, sewer tile, is made simply by the addition of water and the necessary baking process." In this return it based the value of the ground fire clay at $22.81 per ton, the price for which it sold some 80 tons of that material in bags during 1951. At this figure the depletion allowance would have been slightly above $2 per ton. Thereafter respondent claimed error and asserted that its mineral product, rather than being commercially marketable when it reached the stage of ground fire clay, only became commercially marketable when it became a finished product, *i. e.*, sewer pipe. On this basis, the depletion allowance on petitioner's gross income would be approximately $4 per ton, since the mineral would have a value of about $40 per ton. On the other hand, if the mineral it used in 1951 was valued at $1.60 to $1.90 per ton, the going price elsewhere in Indiana, the depletion allowance would be approximately 20c per ton.

The record shows and the District Court found that in 1951 there were substantial sales of raw fire clay and shale in Indiana, mostly in the vicinity of Brazil, about 140 miles from Cannelton. The average price there was $1.60 to $1.90 per ton for fire clay and $1 per ton for shale. Transportation costs from Brazil to Cannelton ran from $4.58 to $5.50 per ton. In Kentucky, across the river from respondent's plant, it appears that fire clay and shale of the same grade were mined and sold [3] before, during and subsequent

[3] The evidence indicates that, for $50, Owensboro Sewer Pipe Company bought from L. R. Chapman five acres of ground under which the shale and clay deposits lay. Contemporaneously it made

to 1951. In fact, since 1957 respondent has secured all of its mineral requirements from this source on a lease basis under which the lessor mines and delivers the raw material to its plant. The exact cost is not shown, but the haul in 1957 from pit to plant, including the ferry crossing was some seven miles.

II

We have carefully studied the legislative history of the depletion allowance, including the voluminous materials furnished by the parties, not only in their briefs but in the exhaustive appendices and the record.[4] We shall not burden this opinion with its repetition.

In summary, mineral depletion for tax purposes is an allowance from income for the exhaustion of capital assets. *Anderson v. Helvering*, 310 U. S. 404 (1940). In addition, it is based on the belief that its allowance encourages extensive exploration and increasing discoveries of additional minerals to the benefit of the economy and strength of the Nation. We are not concerned with the validity of this

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a contract with L. R. Chapman, Inc. to mine and deliver shale and fire clay from this tract to the Owensboro plant for $1.40 per ton. Chapman also testified that in addition he furnished shale and fire clay to other manufacturers in the same area in Kentucky. The arrangements varied. Some were similar to the Owensboro agreement, while others were leases on a royalty basis with a contemporaneous agreement to mine and deliver the clay at a set price. The exact year or years are not clear, but appear to have been between 1949 and 1956. Respondent began using shale and fire clay from the same source by lease arrangement in 1957. The reason for lease arrangements and paper transfer of title is not shown. However, Chapman testified that the manufacturers "didn't seem to want to do the prospecting or the sampling until they were sure they could get either a lease or a deed."

[4] The briefs cover 294 pages and the appendices an additional 685, not including 10 charts. The record is 276 pages.

theory or with the statutory policy. Our sole function is application of the congressional mandate. A study of the materials indicates that percentage depletion first came into the tax structure in 1926, when the Congress granted it to oil and gas producers. The percentage allowed was based on "gross income from the property," which was described as "the gross receipts from the sale of oil and gas as it is delivered from the property." Preliminary Report, Joint Committee on Internal Revenue Taxation, Vol. I, Part 2 (1927). The report continued that, as to the integrated operator, "the gross income from the property must be computed from the production and posted price of oil, as the gross receipts from a refined and transported product can not be used in determining the income as relating to an individual tract or lease." The Treasury Regulations confirmed this understanding. Treas. Reg. 74 (1929 ed.), Arts. 221 (i), 241.

Thereafter, in 1932, percentage depletion was extended to metal mines, coal, and sulphur. The mining engineer of the Joint Committee, Alex R. Shepherd, urged in a report to the Congress[5] that depletion for metal mines be computed, as in the oil and gas industry, on a percentage-of-income basis, and the Revenue Act of 1932 was so drawn. The Shepherd Report pointed out that the percentage basis for oil and gas depletion had been in force for over a year and had "functioned satisfactorily both from economical and administrative viewpoints and without loss of revenue." It added that "careful study of this method as applied to metal mines indicates that the same results will be attained in practice as in the case of oil and gas," but that, because of varied practices in the mining industry, it would

[5] Preliminary Report on Depletion, Staff Report to the Joint Committee on Internal Revenue Taxation (1930), Appendix XXXI (Shepherd Report).

be necessary to determine "the point in accounting at which" gross income from the property mined could be calculated. It recommended that "it is logical to peg 'gross income from the property' f. o. b. cars at mine," *i. e.*, net smelter returns, recognizing that processing beyond this point should not be included in calculating "gross income from the property." While as to certain metals, *viz.*, gold, silver, or copper, the report suggested that gross income should be based on receipts from "the sale of the crude, partially beneficiated or refined" product, this was but to make provision for the specific operations of miners in those metals. In this regard the report also proposed that the depletion base "in the case of all other metals, coal and oil and gas, [should be] the competitive market receipts, or its equivalent; received from the sale of the crude products, or concentrates on an f.o.b. mine, mill, or well basis."

The Congress in fashioning the 1932 Act took into account these recommendations of the industry. It incorporated a provision in the Act allowing percentage depletion for coal and metal mines and sulphur based on the "gross income from the property." § 114 (b)(4), Revenue Act of 1932, 47 Stat. 169. On the following February 10, 1933, the Treasury issued its Regulation 77, which defined "gross income from the property" as "the amount for which the taxpayer sells (a) the crude mineral product or (b) the product derived therefrom, not to exceed in the case of (a) the representative market or field price . . . or in the case of (b) the representative market or field price . . . of a product of like kind and grade from which the product sold was derived, before the application of any processes . . . with the exception of the processes listed. . . ." Treas. Reg. 77, Art. 221 (g). These exceptions listed processes normally in use in the mining industry for preparing the mineral as a marketable shipping product. The regulation was of unquestioned validity and, in 1943, at the instance of the in-

dustry, the Congress substantially embodied it into the statute itself, 58 Stat. 21, 44, including the basic definition of the term "gross income from the property."[6] Since that time the section on percentage depletion—§ 114 (b)(4)(B) of the 1939 Code—has remained basically the same.[7] Additional minerals have been added from time to time—shale and fire clay in 1951—until practically all minerals are included.

As now enacted, the section provides that "mining" includes "not merely the extraction of the ores or minerals from the ground but also the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products," plus transportation from the place of extraction to the "plants or mills in which the ordinary treatment processes are applied thereto," not exceeding 50 miles.[8]

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[6] See, *e.g.*, Hearings before Senate Committee on Finance on H. R. 3687, 78th Cong., 1st Sess. 528; S. Rep. No. 627, 78th Cong., 1st Sess. 23-24; Hearings before House Committee on Ways and Means on Revenue Revisions, 80th Cong., 1st Sess., part 3, at 1857; Hearings before Senate Committee on Finance on H. R. 8920, 81st Cong., 2d Sess. 771; S. Rep. No. 2375, 81st Cong., 2d Sess. 52-53.

[7] The present statute, § 613 of the Internal Revenue Code of 1954, is essentially unchanged.

[8] Internal Revenue Code of 1939, § 114 (b) (4) (B):

"*Definition of Gross Income from Property.*—As used in this paragraph the term 'gross income from the property' means the gross income from mining. The term 'mining' as used herein shall be considered to include not merely the extraction of the ores or minerals from the ground but also the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products, and so much of the transportation of ores or minerals (whether or not by common carrier) from the point of extraction from the ground to the plants or mills in which the ordinary treatment processes are applied thereto as is not in excess of 50 miles unless the Secretary

It then defines "ordinary treatment processes" by setting out specifically in four categories those covering some 17 named minerals. Fire clay and shale are not within these specific enumerations. The Government, however, contends that they should come within clause (iii) of the section, which provides that, "in the case of iron ore, bauxite, ball and sagger clay, rock asphalt *and minerals which are customarily sold in the form of a crude mineral product*—sorting, concentrating, and sintering to bring to shipping grade and form, and loading for shipment . . ." are included in "ordinary treatment processes." (Italics added.) Clause (iv) lists specific metals such as lead, zinc, copper, etc., "and ores which are not customarily sold in the form of crude mineral product," and specifically excludes from the permissible processes certain ones used in connection with

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finds that the physical and other requirements are such that the ore or mineral must be transported a greater distance to such plants or mills. The term 'ordinary treatment processes,' as used herein, shall include the following: (i) In the of coal—cleaning, breaking, sizing, and loading for shipment; (ii) in the case of sulphur—pumping to vats, cooling, breaking, and loading for shipment; (iii) in the case of iron ore, bauxite, ball and sagger clay, rock asphalt, and minerals which are customarily sold in the form of a crude mineral product—sorting, concentrating, and sintering to bring to shipping grade and form, and loading for shipment; and (iv) in the case of lead, zinc, copper, gold, silver, or fluorspar ores, potash, and ores which are not customarily sold in the form of crude mineral product—crushing, grinding, and beneficiation by concentration (gravity, flotation, amalgamation, electrostatic, or magnetic), cyanidation, leaching, crystallization, precipitation, (but not including as an ordinary treatment process electrolytic deposition; roasting, thermal or electric smelting, or refining) or by substantially equivalent processes or combination of processes used in the separation or extraction of the product or products from the ore, including the furnacing of quicksilver ores. The principles of this subparagraph shall also be applicable in determining gross income attributable to mining for the purposes of section 450 and 453." 26 U.S.C., (1952 ed.) § 114.

these metals. To recapitulate, the section contains four categories of dealing with "ordinary treatment processes": the first enumerating those permissible as to the mining of coal; the second, as to sulphur; the third, as to minerals customarily sold in the form of the crude mineral product; and the fourth, as to those minerals not customarily so sold. We note that the Congress even states the steps in each permissible process, and in addition specifically declares some processes not to be "ordinary treatment" ones, *viz.*, "electrotlytic deposition, roasting, thermal or electric smelting, or refining." Furthermore, none of the permissible processes destroy the physical or chemical identity of the minerals or permit them to be transferred into new products.

From this leglative history, we conclude that Congress intended to grant miners a depletion allowance based on the constructive income from the raw mineral product if marketable in that form, and not on the value of the finished articles.

III

The findings are that three-fifths of the fire clay produced in Indiana in 1951 was sold in its raw state. This indicates a substantial market for the raw mineral. In addition, large sales of raw fire clay and shale were made across the river in Kentucky. This indicates that fire clay and shale were "commercially marketable" in their raw state unless that phrase also implies marketability at a profit. We believe it does not. Proof of these sales is significant not because it reveals an ability to sell profitably—which the respondent could not do—but because the substantial tonnage being sold in a raw state provides conclusive proof that, when extracted from the mine, the fire clay and shale are in such a state that they are ready for

industrial use or consumption—in short, they have passed the "mining" state on which the depletion principles operate. It would be strange, indeed, to ascribe to the Congress an intent to permit each miner to adopt processes peculiar to his individual operation. Depletion, as we have said, is an allowance for the exhaustion of capital assets. It is not a subsidy to manufacturers or the high-cost mine operators. The value of respondent's vitrified clay products, obtained by expensive manufacturing processes, bears little relation to the value of its minerals. The question in depletion is what allowance is necessary to permit tax-free recovery of the capital value of the minerals.

Respondent insists that its miner-manufacturer status makes some difference. We think not. It is true that the integrated miners in Indiana outnumbered the nonintegrated ones. But in each of the three basic percentage depletion Acts the Congress indicated that integrated operators should not receive preferred treatment. Furthermore, in Regulation 77, discussed above, the Treasury specifically provided that depletion was allowable only on the crude mineral product. And, as we have said, this regulation was substantially enacted into the 1943 Act. We need not tarry to deal with any differences which are said to have existed in administrative interpretation, for here we have authoritative congressional action itself. Ever since the first percentage depletion statute, the cut-off point where "gross income from mining" stopped has been the same, *i. e.*, where the ordinary miner shipped the product of his mine. Respondent's formula would not only give it a preference over the ordinary nonintegrated miner, but also would grant it a decided competitive advantage over its nonintegrated manufacturer competitor. Congress never intended that depletion create such a discriminatory situation. As we see it, the miner-manufacturer is but selling to

himself the crude mineral that he mines, insofar as the depletion allowance is concerned.

IV

We now reach what "ordinary treatment processes" are available to respondent under the statute. As the principal industry witness put it at hearings before the Congress: "Obviously it was not the intent of Congress that those processes which would take your products and make them into different products having very different uses should be considered, as the basis for depletion."[9] But respondent says that the processes it uses are the ordinary ones applied in the industry. As to the miner-manufacturer, that is true. But they are not the "ordinary" normal ones applied by the nonintegrated miner. It was he whom the Congress made the object of the allowance. The fabrication processes used by respondent in manufacturing sewer pipe would not be employed by the run-of-the-mill miner—only an integrated miner-manufacturer would have occasion to use them.

Respondent further contends, however, that it must utilize these processes in order to obtain a "commercially marketable mineral product or products." It points out that its underground method of mining prevents it from selling its raw fire clay and shale. This position leads to the conclusion that respondent's mineral product has no value to it in the ground. If this be true, then there could be no depletion. One cannot deplete nothing. On the other hand, respondent alleges that its minerals "yield the best sewer pipe which is made in Indiana." If this be true, then respondent's problem is one purely of cost of recovery, an

[9] Robert M. Searls, Attorney, San Francisco. Silver Subcommittee Hearings, 1942, p. 764.

item which as we have said, has nothing to do with value in the depletion formulae. Depletion, as we read the legislative history, was designed not to recompense for costs of recovery but for exhaustion of mineral assets alone. If it were extended as respondent asks, the miner-manufacturer would enjoy, in addition to a depletion allowance on his minerals, a similar allowance on his manufacturing costs, including depreciation on his manufacturing plant, machinery and facilities. Nor do we read the use by the Congress of the plural word "products" in the "commercially marketable" phrase as indicating that normal processing techniques might include the fabrication of different products from the same mineral. We believe that the Congress was only recognizing that in mining operations often more than one mineral product was recovered in its raw state.

In view of the finding that substantial quantities—in fact, the majority—of the tonnage production of fire clay and shale were sold in their raw state, we believe that respondent's mining activity during the year in question would come under the clause (iii) of the section here involved. That clause includes "minerals which are customarily sold in the form of a crude mineral product." We believe that the Congress intended integrated mining-manufacturing operations to be treated as if the operator were selling the mineral mined to himself for fabrication. It would, of course, be permissible for such an operator to calculate his "gross income from mining" at the point where "ordinary" miners—not integrated—disposed of their product. All processes used by the integrated miner before shipping the raw fire clay and shale would under such a formula be available to the integrated miner-manufacturer to the same extent but no more.

Nor do we believe that the District Court and Court of Appeals cases involving percentage depletion and cited by

respondent are opposite here[10]. We do not, however, indicate any approval of their holdings. It is sufficient to say that on their facts they are all distinguishable.

In view of these considerations, neither of respondent's alternate claims for depletion allowance is appropriate. The judgment of the Court of Appeals is therefore reversed, and the cause remanded for further proceedings in conformity with this opinion.

It is so ordered.

[10] Respondent's cases are based on *United States* v. *Cherokee Brick & Tile Co.*, 242 F. 2d 424 (adhered to in *United States* v. *Merry Bros. Brick & Tile Co.*, 242 F. 2d 708), which went off on factual concessions not present here. They have been pyramided into a statistically imposing number of cases, predicated upon one another. Close analysis indicates that they either go off on concessions, or findings not present here, or deal with controversies over particular treatment processes claimed as "ordinary" in the industry involved. For our purposes, we need not reach the question of whether in those cases the minerals in place had any "value" to be depleted. Other than the decision here under review, only two of the Court of Appeals cases cited by respondent, both from the same Circuit (*Commissioner* v. *Iowa Limestone Co.*, 269 F. 2d 398, *Brookwalter* v. *Centropolis Crusher Co.*, 272 F. 2d 392), adopt the profitability test, which we find unacceptable.

SUPREME COURT OF THE UNITED STATES

No. 513.—October Term, 1959

United States of America, Petitioner, v. Cannelton Sewer Pipe Company.	On Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit.

[June 27, 1960.]

Mr. Justice Harlan, concurring in the result.

In joining the judgment in this case I shall refer only to one matter which, among the voluminous data presented by the parties, is for me by far the most telling in favor of the Government's position.

Treasury Regulation 77, promulgated in 1933 under the Revenue Act of 1932 (47 Stat. 169), defined the basic term "gross income from the property" contained in §114(b)(4) of the 1932 Act and carried forward in its successors. Art. 221 (g). It concededly supports, by its express terms (see *ante*, p.——), the position of the Government in the present case. In my opinion the regulation was undoubtedly a valid exercise of the Commissioner's power to construe a generally worded statute. See Preliminary Report on Depletion, Staff Reports to the Joint Committee on Internal Revenue Taxation (1930), p. 68 (Shepherd Report); *Helvering* v. *Wilshire Oil Co.*, 308 U.S. 90, 102-103. The Revenue Act of 1943 (58 Stat. 21, 45), which added to the 1939 Code the provisions governing this case, represented only a limited departure from the 1933 Regulation, or from the administrative action taken under it, principally in the area of extractive processes applied to minerals not customarily sold in the form of a

crude product, and did not basically affect the meaning of the term "gross income from the property." See, *e.g.*, Revenue Act of 1943, Hearings before the Senate Committee on Finance, 78th Cong., 1st Sess., on H. R. 3687, pp. 527-529; S. Rep. No. 627, 78th Cong., 1st Sess., pp. 23-24; Revenue Revision of 1942, Hearings before the House Committee on Ways and Means, 77th Cong., 2d Sess., p. 1202; cómpare *id.*, at 1199; Silver, Hearings before the Senate Special Committee on the Investigation of Silver, 77th Cong., 2d Sess., pursuant to S. Res. No. 187 (74th Cong.), pp. 761-764. Respondent's efforts to impugn the force of that regulation, see Shepherd Report, *supra*, at 70, 71; Revenue Revisions, 1947-1948, Hearings before the House Committee on Ways and Means, 80th Cong., 1st Sess., p. 3283; Mineral Treatment Processes for Percentage Depletion Purposes, Hearings before the House Committee on Ways and Means, 86th Cong., 1st Sess., pp. 258, 264, seem to me quite unpersuasive.

This history, in my view, provides an authoritative and controlling gloss upon the term "commercially marketable mineral product or products" in the statutory definition of "mining," which in turn constitutes the "property" with which the statute deals. See *Helvering* v. *Wilshire Oil Co.*, *supra*. It results on this record, in limiting respondent's basis for depletion to its constructive income from raw fire clay and shale.

SUPREME COURT OF THE UNITED STATES

R. A. Riddell, District Director of Internal Revenue

v.

Monolith Portland Cement Co.

No. 528

Decided Jan. 14, 1963.

PER CURIAM.

The taxpayer respondent during the taxable year 1952 mined limestone from its own quarry, crushed it, transported the crushed product two miles to its plant, and there, through the addition of other materials and further processing, manufactured the limestone into cement which it sold. It paid taxes for the year mentioned, based on a depletion allowance computed in accordance with Treasury Regulations. Thereafter taxpayer filed claim for refund and now prosecutes this suit on the ground that the depletion allowance should not have been based upon constructive income at the crushed limestone stage, but rather upon gross receipts from sales of the mining product after its "treatment processes" were completed and it became finished cement.[1] The District Court found that the taxpayer's depletion base was the income from the sale of finished cement, and the Court of Appeals affirmed. 301 F.2d 488.

Section 23(m) of the Internal Revenue Code of 1939, 53 Stat. 14, 26 U.S.C.A. § 23(m), provided that in computing

[1] There is no question involved here under the Act of September 14, 1960, 74 Stat. 1018, since taxpayer elected to pursue his claim for depletion on the finished cement product rather than accept as a correct cut-off point for depletion the prekiln feed stage of manufacture as permitted by that Act.

taxable net income certain percentage deductions from gross income should be allowed for depletion of mines. The Congress further provided, § 114(b) (4) of the Act, as amended, c. 63, § 124(c) (B), 58 Stat. 45 (1944), that included within the term "mining" were "the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product . . . ."

In United States v. Cannelton Sewer Pipe Co., 364 U.S. 76, 80 S.Ct. 1581, 4 L.Ed.2d 1581 (1960), we considered at some length the application of this term to the mining industry and held that the statutory percentage depletion allowance on the gross income of an integrated mining operator should be cut off at the point where the mineral first became suitable for industrial use or consumption. After careful study of the record here we believe that this case is controlled by Cannelton. We concluded there "that Congress intended to grant miners a depletion allowance based on the constructive income from the raw mineral product, if marketable in that form, and not on the value of the finished articles." 364 U.S. at 86, 80 S.Ct., at 1586. We found that "the cut-off point where 'gross income from mining' stopped has been the same" ever since the first depletion statute, namely, "where the ordinary miner shipped the product of his mine." Id. at 87, 80 S.Ct. at 1587. It therefore appears from this record that the "property" with which the Act deals here is the taxpayer's product at the point when "mining" terminated, *i. e.*, when it reached the crushed limestone stage.[2] This results in lim-

[2] In this connection crushed limestone was not only "marketable in that form" but, according to the Bureau of Mines Minerals Yearbook, 1952, p. 26, an exhibit in the record, it was actually sold in California in 1952 in an amount exceeding 1,500,000 tons. Sales in the United States for that year exceeded 216,000,000 tons. Both of these figures exclude the tonnage used in the manufacture of cement. A stipulation in the record shows that limestone sold or used for all purposes totaled almost 300,000,000 tons in 1952.

iting the taxpayer's basis for depletion to its constructive income from crushed limestone, rather than from finished cement.

The petition for certiorari is therefore granted, the judgment reversed, and the case is remanded for disposition in accordance with this opinion. It is so ordered.

Reversed and remanded.

Mr. Justice WHITE took no part in the consideration or decision of this case.

ALABAMA BY-PRODUCTS CORPORATION, Appellant,

v.

GEORGE D. PATTERSON,
District Director of Internal Revenue, Appellee.

No. 16840.

United States Court of Appeals
Fifth Circuit.

Aug. 29, 1958.

Before HUTCHESON, Chief Judge, and BROWN and WISDOM, Circuit Judges.

WISDOM, Circuit Judge.

Alabama By-Products Corporation filed suit to recover income and excess profit taxes for 1952. Recovery depends on the right of this taxpayer to an allowance for percentage depletion on certain coking coal mined by the taxpayer and converted into foundry coke in its by-product coke-ovens.

Section 23(m) of the 1939 Internal Revenue Code, 26 U.S.C.A. § 23(m), provides for "a reasonable allowance for depletion" of mines. Section 114(b)(4) of the 1939 Code allows percentage depletion on coal at the rate of 10 per cent of "gross income from mining" coal, such allowance not to exceed 50 per cent of the "net income from mining" coal. Section 39.23(m)-1(e)(3) of Treasury Regulations 118 allows a taxpayer to use the proportionate profits method[1] of computing "gross income from property" for purposes of determining percentage depletion. This method

[1] Under the proportionate profits method, if a taxpayer's mining costs amount, say, to 40 per cent of the total costs of all operations, then 40 per cent of the total gross sales constitutes gross income from mining.

may be used, however, only if there is no "representative market or field price of [coal] of like kind and grade." The case, therefore, narrows down to the question, did the taxpayer, Alabama By-Products Corporation, discharge its burden of proving by a fair preponderance of the evidence that there was in the Birmingham area no "representative market or field price of [coal] of like kind and grade" to its Mary Lee and Black Creek coking coal mined by it in 1952?

The case was tried without a jury. The district court held that the taxpayer had failed to discharge its burden; all bituminous coal mined and marketed in the Birmingham area, having coking properties for commercial usage, is coal of "like kind and grade" to the taxpayer's Mary Lee and Black Creek coal. We agree.

I.

Alabama By-Products Corporation, the taxpayer, is engaged in the business of mining and selling coal, manufacturing coke, and selling coke and coal by-products. In 1952 the company mined coal from the Mary Lee and Black Creek seams of the Warrior coal field in Alabama. The Warrior field is one of four bituminous coal fields in the state.

With respect to the Mary Lee seam, taxpayer operated mines at Praco, Colta, and Labuco. All of this coal was cleaned, broken, sized, and loaded for shipment at a preparation plant located at the Praco mine. Coal from the Black Creek seam was extracted from mines located at Bradford and Thermal. This coal was also cleaned, broken, sized, and loaded for shipment by the taxpayer at preparation plants located at the respective mines.

Most of the coal the taxpayer mined was utilized at its own coke ovens in the manufacture of coke to make grey

iron foundry coke and malleable iron foundry coke. Some coal was sold to others in the mining area. The taxpayer purchased some coking coal from other mining companies as well. Furthermore, there were extensive sales of coking coal mined from the three other bituminous coal fields by other mining companies, as well as from the Warrior field.

After the Mary Lee coking coal was prepared at the plant at Praco, Alabama By-Products sold 86,690 tons to purchasers at prices ranging from $5.05 to $7.93 per ton. 44,691 tons of the Mary Lee coking coal were sold to a competitor, DeBardeleben Coal Corporation, at prices ranging from $6.30 to $6.89 per ton. DeBardeleben's coke was sold on the same market as that of the taxpayer, and the prices received by DeBardeleben for such coke were substantially the same as those received by taxpayer. Some of their customers were the same. In addition to purchasing from the taxpayer, DeBardeleben purchased other coking coal from the Black Diamond Coal Mining Company, the Twin Seam Mining Company, and coal mined from the Blue Creek seam in Jefferson County, Alabama. DeBardeleben blended all of these coking coals in the manufacture of its coke.

Republic Steel Corporation also made extensive purchases of Mary Lee coking coal. Some of these purchases were from taxpayer, some were from other vendors. In addition, coal for Republic's coke manufacturing was also purchased from the Pratt and Brookwood seams. The T.C.I. Division of United States Steel Corporation and United States Pipe and Foundry Company also purchased Alabama coking coals during 1952.

As to the Black Creek seam, Alabama By-Products purchased 84,402 tons from Calvert and Youngblood, and 8,950

tons from small truck miners near the Bradford mine at prices ranging from $5.50 to $6.50 per ton. The taxpayer did not sell any Black Creek coal for use in the manufacture of coke by others in 1952; however, some of this coal was sold for use as blacksmith coal at prices ranging from $9.31 to $10.65 per ton. The taxpayer also made some sales to its employees pursuant to union contracts. All of the washed Black Creek coal produced by Dixie Fire Brick Company was purchased by taxpayer at $6.50 per ton.

There were also a number of sales agencies in Birmingham engaged in selling coking coal. One sales agency alone, the Smith Coal Sales Company, sold 371,655 tons of coal in 1952. Of this tonnage, 221,697 tons were coking coals, and of that amount, 98,416 tons were sold for coking purposes. Taxpayer's own sales were made at prices below its average cost of production, but there is no showing that sales by other companies were made under such circumstances.

Turning now to the taxpayer's tax liabilities, the taxpayer reported a gross income of $6,233,080.10 and a net income of $4,555,457.81 in 1952. In computing net income, Alabama By Products deducted $21,962.04 for depletion of mineral resources; of this amount, $20,729.50 was for the cost depletion of coal. In determining its depletion allowance for coal, the taxpayer used a representative market or field price based on sales made and computed a percentage depletion deduction. Mining operations were conducted at a loss in 1952. As a result, there was no net income, and the taxpayer could not take the percentage depletion deduction, since it is limited to 50 per cent of net income from mining, under Section 114 (b) (2) of the Internal Revenue Code of 1939. The taxpayer was allowed to take cost depletion in the amount of $20,729.50.

Based upon the foregoing computations, Alabama By-Products paid income and excess profits taxes for 1952 in the amount of $2,708,371.59, January 18, 1954, the taxpayer filed a claim for refund with the District Director in the amount of $588,586.97. On February 12, 1956, the District Director assessed additional income taxes, and interest thereon, in the amount of $2,068.18, which were paid. February 23, 1956, the taxpayer filed an amended claim for refund, in substitution for the earlier claim, in the amount of $590,353.16. The claims for refund were based on the taxpayer's revised computation of gross and net income for 1952, on the ground that there was no representative market or field price for coal of like kind and grade, and that Alabama By-Products was therefore entitled to use the proportionate profits method to determine gross and net income from mining in computing its percentage depletion deduction.

These claims were disallowed by the District Director and the taxpayer sued for a refund on March 9, 1956. The original complaint stated that there was no representative market or field price of a coal of like kind and grade. On February 11, 1957, the taxpayer filed an amended complaint stating, in the alternative, that if there was a representative market price for its coal, then its net income from mining was improperly computed because overhead and other costs had been improperly allocated to mining operations. On April 2, 1957, after the trial of the case the taxpayer attempted to amend the complaint a second time. This second amendment stated, in the alternative, that if the taxpayer had not carried the burden of proving that there was no representative market or field price, then such price, if it existed, was greater than that originally used in computing the percentage depletion.

The District Court concluded that Alabama By-Products had failed to show that in the Birmingham area there was

no representative market or field price for coal of like kind and grade. The taxpayer was not, therefore, entitled to use the proportionate profits method. As to the amended claims, the court said that they were not raised by the original claim for refund and could not be raised at the trial.

II.

Section 23(m) of the Internal Revenue Code of 1939 provides an allowance for depletion, which, in the case of coal, is equal to the cost of the property depleted or its discovery value.[1] If percentage depletion is utilized Section 114(b)(4)(A) provides that the allowance is equal to 10 per cent of the "gross income from property" during the taxable year. Section 114(b)(4)(A) also provides that in no case can the percentage depletion allowance exceed 50 per cent of the net income of the taxpayer from the property. "Gross income from the property" is defined by the statute to mean "gross income from mining", and "mining" is defined as including the ordinary treatment processes normally applied in order to obtain a commercially marketable mineral product, after the mineral has been extracted from the ground.[2]

[1] Internal Revenue Code of 1939
"§ 23. Deductions from gross income.
In computing net income there shall be allowed as deductions
(m) Depletion. In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case, such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner with the approval of the Secretary . . ."

[2] Section 114(b)(4)(B) provides
"As used in this paragraph the term 'gross income from the

Section 39.23(m)-1(e) (3) of Treasury Regulations 118 provides that if, as here, the mineral product is processed before sale by processes in addition to the ordinary treatment processes, then "gross income from the property" means the representative market or field price as of the date of sale of a mineral product (in this case, coal) of the "like kind and grade" at the ordinary treatment processing stage. If there is no representative market or field price, then the so-called proportionate profits method of computing income may be used.[4]

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property' means the gross income from mining. The term 'mining' as used herein shall be considered to include not merely the extraction of the ores or minerals from the ground but also ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products, and so much of the transportation of ores or minerals (whether or not by common carrier) from the point of extraction from the ground to the plants or mills in which the ordinary treatment processes are applied thereto as is not in excess of 50 miles unless the Secretary finds that the physical and other requirements are such that the ore or mineral must be transported a greater distance to such plants or mills. The term 'ordinary treatment processes', as used herein, shall include the following (i) in the case of coal—cleaning, breaking, sizing, and loading for shipment; * * *."

[4] "Treasury Regulations 118, promulgated under the Internal Revenue Code of 1939:

"Sec. 39.23(m)-1 [as amended by T.D. 6096, 1954-2 Cum. Bull 69]. Depletion of mines, oil and gas wells, other natural deposits and timber; depreciation of improvements.

* * * * * * *

"(e) As used in sections 114(b)(3) and 114(b)(4)(A) and §§ 39.23(m)-1 to 39.23(m)-19, inclusive, the term 'gross income from the property' means the following:

* * * * * * *

"(3) If the taxpayer sells the crude mineral product of the property in the immediate vicinity of the mine, 'gross income from the property' means the amount for which such product was sold,

Alabama By-Products contends that the phrase "mineral product of like kind and grade" as used in Section 39.23(m)-1(e) (3) refers to mineral products with the same inherent attributes and characteristics as the depletable mineral in question. The taxpayer points to the many physical and chemical properties that distinguish kinds of coking coals.[5]

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but, if the product is transported or processed (other than by the ordinary treatment processes described below) before sale, 'gross income from the property' means the representative market or field price (as of the date of sale) of a mineral product of like kind and grade as beneficiated by the ordinary treatment processes actually applied, before transportation of such product (other than transportation treated, for the taxable year, as mining). If there is no such representative market or field price (as of the date of sale), then there shall be used in lieu thereof the representative market or field price of the first marketable product resulting from any process or processes (or, if the product in its crude mineral state is merely transported, the price for which sold) minus the costs and proportionate profits attributable to the transportation (other than transportation treated, for the taxable year, as mining) and the processes beyond the ordinary treatment processes. If the taxpayer establishes to the satisfaction of the Commissioner that another method of computation, other than the computation of profits proportionate to costs, clearly reflects the gross income from the property, then such gross income shall be computed by the use of such other method."

[5] "Coke is manufactured by placing dry bituminous coking coal crushed to sizes ½" x 0" or smaller in a closed retort and applying heat. A coking coal under the influence of heat, first softens and then at a higher temperature becomes fluid; at a still higher temperature the coal decomposes with accompanying evolution of gas; and at a still higher temperature the gas is driven off and the bituminous in the coking coal, acting as an agglutinating agent, bind the remaining materials together to form a cellular structure called coke. A satisfactory coking coal must have sufficient bitumens to bind the other components of the coal together. The agglutinating characteristics or bitumen content of coking coals vary widely among different coals. A non-coking coal has either

Coking coals differ as to volatile matter, ash content, carbon pickup, sulphur content, porosity, and phosphorous content. These differences in coal will cause different kinds of coke to be produced when the coal is heated. The differences in coke, in turn, determine to a large extent the nature of the end product in the manufacture of steel and pig iron. The taxpayer's customers require certain kinds of coke, depending upon the type iron or steel they manufacture. The taxpayer does not go so far as to say that only coking coal with the identical chemical and physical characteristics as that used by the taxpayer to manufacture coke suitable for its own needs is a "mineral product of like kind and grade". The taxpayer does say that the comparison must be with a coking coal that has the same capacities for profitable use; that only coking coals "interchangeable" with appellant's coking coals are of like kind and grade. None of the coking coals sold in 1952 by other companies were suitable to the taxpayer for its use in the manufacture of coke. The taxpayer argues therefore that none of the coking coal sold was of a "like kind and grade" to the taxpayer's.

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none or too few bitumens to give the coal agglutinating properties and such a coal will not form a satisfactory coke.

"In addition to containing the necessary agglutinating or coking properties a coking coal must have the proper amounts of fixed carbon and volatile matter to make a commercially usable coke and must be low in ash and sulphur to produce foundry coke. A chemical proximate analysis of a coking coal reflects the amounts of fixed carbon, volatile matter, sulphur and ash contained in a coking coal. Coking coals differ substantially in the amount of carbon which the foundry coke made therefrom imparts to the material heated by such foundry coke, such characteristics being referred to as the carbon pickup quality of the coking coal. Coking coals also vary with respect to the physical structure of the coke made therefrom, the strength of a particular coke varying with the size of the air cells and thickness of the walls of the air cells in a piece of coke." Appellant's brief.

The common practice in the industry to avoid effects of different physical and chemical characteristics among coking coals is to blend several types of the coal.[6] Blends are constantly adjusted to compensate for the differences in coals so that in effect the only distinction with any commercial substance is whether the coal is of coking or non-coking quality.[7] Alabama By-Products does not, however, blend its coals.

The taxpayer argues that since other coking coals can not meet taxpayer's uses, they are not of like kind and grade.[8] The "end use" test has been rejected by the courts even where it has been specifically mentioned in the tax regulations, and advocated by the Government in arguing some of the cases.[9] Iowa Limestone Co. v. C.I.R., 1957, 28 T.C. 881; Spencer Quarries, Inc., v. C.I.R., 27 T.C.

[6] Coal for furnace cokes need not necessarily be blended, but coal for foundry cokes usually must be blended.

[7] But no blends of coal which did not include the Mary Lee coals produced in the Praco area could result in a sufficiently low carbon pickup in the metal being melted by appellant's coke customers to produce a coke for a malleable iron foundry.

[8] "The court found that Pratt and American seam coals are not suitable for use by taxpayer in making its foundry coke and Brookwood-Milldale seam coals will not make a foundry coke to conform to taxpayer's specifications. Blue Creek seam coal mined from the Black Diamond Mining Company's Johns and Adger mines differs from taxpayer's Mary Lee coals, in that the latter has a lower carbon pickup; the Underwood seam coal differs from taxpayer's Black Creek seam coal in that the volatile ash and sulphur content of the former was higher and the coking properties lower and such coal was undesirable for taxpayer's foundry coke. However, Blue Creek, Brookwood, Pratt, Thompson, Woodstock, Bynum, and Black Creek seam coals were consistently and extensively sold, as coking coal, in the Birmingham districts in the years 1951-1955." Appellant's brief.

[9] See Rev. Rul. 56-59, 1956-1, C.B. 626; GCM 24185, 1944, C.B. 132; Treas. Regs. 118, Section 39.23(m)-5(b). The "end use" test would not be applicable here even if accepted by the courts.

392; Virginia Limestone Corp. v. C.I.R., 1956, 26 T.C. 553. In the Spencer Quarries case the issue was whether quartzite used as a refractory material should receive different depletion treatment than quartzite used for other commercial purposes. The Tax Court held that quartzite is quartzite, and the particular use for which it is suitable will not make it another kind of material; therefore, uniform treatment was given. Section 39.23(m)-5(b) of Treasury Regulations 118 does make percentage depletion applicable to certain minerals, "used or sold for use" for a stated purpose. Here, in another part of the Regulations, however, the Treasury Department has merely used the phrase "mineral product of like kind and grade". We cannot assume that it was intended that the use to which the property was actually put should be decisive in classifying mineral products for purposes of the representative market price and proportionate profits methods of computing the gross income from mining.

Counsel have cited no cases in their brief that interpret the crucial phrase. We have been unable to find any.

This Court has been called upon more than once to interpret the phrase "like kind" as it is used elsewhere in the 1939 Code. We have consistently held that "like kind" is a broad phrase contemplating the distinction between classes of property (for example, personal and real) no matter how dissimilar they may be in location, in attributes, and in capacities for profitable use. Fleming v. C.I.R., 5

By the very terms of the statutes and regulations mentioning this test, it applied only to clay, brick and tile, limestone, and calcium carbonates that are used for a stated purpose. Such minerals are entitled to percentage depletion only if used for the stated purpose, whereas, percentage depletion applies to all coal regardless of its use. Thus, end use has no bearing on "like kind and grade". See Treas. Regs. 118, Section 39.23(m)-5(b).

Cir., 1957, 241 F.2d 78; Fleming v. Campbell, 5 Cir., 1953, 205 F.2d 549; C.I.R. v. Crichton, 5 Cir., 1941, 122 F.2d 181. The District Court held, and we agree, that all bituminous coals are of like kind, or of the same general property classification.

The phrase "like grade" as it is used here, has not been interpreted. There is no indication that a narrow interpretation of this phrase was intended. Section 39.23(m)-7 of the Regulations indicates that a liberal interpretation was contemplated:

> "(a) If the fair market value of the property at a specified date is to be determined for the purpose of ascertaining the basis for depletion and depreciation deductions, • • • [t]he value sought should be that established assuming a transfer between a willing seller and a willing buyer as of that particular date. The Commissioner will give due weight and consideration to any and all factors and evidence having a bearing on the market value, such as cost, actual sales and transfers of *similar* properties. • • • •"

It is not unlikely that the term "similar properties" contemplates a "mineral product of like kind and grade".[10] The

[10] There is dictum in C.I.R. v. Crichton, 5 Cir., 1941, 122 F.2d 181 that might indicate that the refined distinctions such as taxpayer argues should be recognized and that the phrase "mineral product of like kind and grade" should be narrowly construed. The court said that "like kind" is general, and does not contemplate "dissimilarities in grade or quality, the unlikeliness, in attributes, appearance and *opacities*." Taxpayer would construe this as an interpretation of "like grade". This is tenuous because the phrase "like grade" was in no way involved in this case, nor was it ever mentioned.

The proposed regulations to section 613 of the 1954 Code, 26 U.S.C.A. § 613, strengthen our view that "like kind and grade" contemplates similar properties. The regulations provide in part:

> "4 • • • For the purposes of this paragraph the term 'market price' means the price • • • at which the gross income product

District Court concluded that all bituminous coals in the Alabama fields are of like grade if commercially suitable for use in the manufacture of coke generally, regardless of the taxpayer's particular needs. To go further and classify coking coals according to their myriad of actual uses would lead to an unworkable system of grading coal, since the requirements of coke users vary so greatly. There would never be, in the case of coking coal, a "mineral product of like kind and grade"; we would have a phrase without meaning.

The sales and purchases of coking coal by Debardeleben, Republic, United States Steel, United States Pipe and Foundry and others were extensive enough to establish a representative market price. Although the sales made by the taxpayer were in the nature of "forced" sales to peculiar economic conditions,[11] the sales of coking coal by

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is sold commercially • • •. If there are no such commercial sales in such area, then the market price of the gross income product must be determined by the use of other appropriate methods with the objective of determining as accurately as practicable the price at which such gross income product would be sold if such commercial sales existed."

One such appropriate method is:

"(i) Comparison with the prices at which crude mineral products *similar to the taxpayer's* gross income product are sold commercially in the vicinity of the taxpayer's mine with proper adjustment being made for material differences, if any, between taxpayer's gross income product and the products sold commercially (such as differences in kind or grade *or mineral content* or ordinary treatment processes involved or transportation costs between mine and market or relative volume of sales)." Proposed Regulations, Section 1.615-3, P-H. Internal Revenue Code, p. 24,618.10.

Thus, mineral content is distinguished from kind and grade in the proposed regulations.

[11] The record shows that since World War I the coal industry has been declining and uncertain. As a result, plants operated on a three day work week and employees were dissatisfied. To

the other companies were the natural result of competitive bargaining, and principles of supply and demand. This is enough to create a true market in commerce." Helvering v. Walbridge, 2 Cir., 1934, 70 F.2d 683; Heiner v. Crosby, 3 Cir., 1928, 24 F.2d 191. What Judge Learned Hand had to say in the Walbridge case is applicable here [70 F.2d 684]:

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remedy this, and to spread overhead costs, taxpayer made sales at prices less than its cost of production. Such sales were not made in open and free competition.

[12] Riverton Lime and Stone Co. v. C.I.R., 1957, 28 T.C. 446, indicates that even a small, declining market can establish a representative market or field price. The Tax Court held that although there were only small sales of pure lime, the price received was the representative market or field price. The proportionate profits method was not allowed because it allocated too large a percentage of the total profit realized by the taxpayer to processes used for producing a better product. The fact remains, however, that the court allowed a sales price in a restricted number of sales to stand as the representative market or field price.

The taxpayer argues that the Riverton case is erroneous and relies strongly on United States v. Cherokee Brick & Tile Co., 5 Cir., 1955, 218 F. 2d 424, 425. In that case the taxpayer mined clay which it used to make burnt brick. "Gross income from mining" includes income realized from the first commercially marketable mineral product obtained from ordinary treatment processes. The Government contended that the first commercially marketable mineral product was the clay itself, and that in computing gross income that which the taxpayer realized from its sales of clay should be included. The court rejected this contention, stating:

"The complaint alleges that, of the brick and tile clay mined in the United States, there is opportunity for the sale of only a negligible quantity before it is put into the form of burnt brick and tile. This allegation is admitted in the answer of the [Government]. For this and other reasons (but mainly for this one) stated in the opinion of the district court, above cited, the judgment appealed from should be affirmed."

The Cherokee Brick & Tile case is not applicable. The question of whether there was a representative market price for clay at

> "Perhaps there need not be a 'market' to establish a 'market value,' but there must be some assurance that the value is what a 'market' would establish; and a 'market' itself presupposes enough competition between buyers and sellers to prevent the exigencies of an individual from being exploited. It may well imply that the goods have several possible buyers, so that a necessitous seller shall not be confined to one; and that there are several possible sellers of the same goods or their *substantial* equivalent, so that a hard pressed buyer shall not have to accept the first offer."

There is no contention that the coking coal sold by other companies and agencies is identical with taxpayer's; but, for practical purposes, it was of "like kind and grade", a "substantial equivalent" sold and purchased in free competition.

The proportionate profits method provided by the Regulations was not intended to assure percentage depletion to a taxpayer who conducts his mining operations at a loss. It is designed to operate only with respect to gross income, subject to the 50 per cent limitation, and only when there is no representative market or field price at the ordinary treatment processing stage. If there is such a price at which the taxpayer could sell, but it happens that the taxpayer, as here operates that phase of the business at a loss, then the 50 per cent net income limitation precludes the allowance. The taxpayer's remedy lies with Congress.

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the stage of processing prior to the manufacturing of the finished brick was not involved; the issues were limited to whether the processes applied were ordinary treatment processes, and whether the finished product was a mineral product. Mertens, Law of Federal Income Taxation, Section 24.32b, n. 76. The issue here is whether there exists a representative market price for a mineral product of like kind and grade to coking coal mined by the taxpayer. Cherokee Brick & Tile does not help to answer this.

Summarizing, we have a situation here that calls for some workable definition of the phrase "mineral product of like kind and grade". Of course there are differences in coal. Here, it seems to us, as a practical matter, the differences are meaningless if a coal meets the standard of coking quality. In effect, this is the standard used commercially in the area. The Commissioner would have a difficult, if not impossible, task, if he had to determine whether one coal was "interchangeable" with another coal; there are so many variables in the composition of coal, that even all coal from the same seam is not necessarily interchangeable. We agree, therefore, with the district court that "like kind and grade" means as to "kind", all bituminous coals mined in the Birmingham area, and, as to "grade", means all coals having coking quality suitable for commercial use. Since the taxpayer's coals are of like kind and grade to other coking coals that were sold in the area, the taxpayer has failed to meet its burden of proving that there was no representative market or field price for its coals.

III.

We affirm also the dismissal of the amended claims for refund. All grounds upon which a taxpayer relies must be stated in the original claim for refund so as to apprise the Commissioner of what to look into; the Commissioner can take the claim at its face value and examine only those points to which his attention is necessarily directed. United States v. Garbutt Oil Co., 1938, 302 U.S. 528, 58 S.Ct. 320, 82 L.Ed. 405. Anything not raised at that time cannot be raised later in a suit for refund. Carmack v. Scofield, 5 Cir., 1953, 201 F.2d 360, 362. The taxpayer's claim for refund was based solely on the ground that there was no representative market price. There was no attempt to raise the question of the correctness of an existing representative price. In fact, the claim for refund precluded this question.

There was likewise no attempt to raise the question of any improper allocation of overhead and other expenses.

What we said in the Carmack case applies with equal vigor here:

> "A taxpayer is not permitted to advance one ground for refund in his claim filed with the Commissioner and thereafter rely upon an entirely different ground in a subsequent suit for refund, *but is confined to the scope of the grounds for refund asserted in his claim filed with the Commissioner.*"

The judgment is

Affirmed.

HENDERSON CLAY PRODUCTS,
Plaintiff,
v.
UNITED STATES OF AMERICA,
Defendant.
Civ. A. No. 2463.

United States District Court
E. D. Texas,
Tyler Division.
Sept. 6, 1961.

SHEEHY, Chief Judge.

Plaintiff instituted this suit on January 27, 1958, seeking a refund of income and excess profits taxes, together with interest thereon, assessed against it by the Commissioner of Internal Revenue, hereinafter referred to as Commissioner. The facts as admitted by the parties and as found by the Court as well as the contentions of the parties are as hereinafter stated.

Plaintiff is a Texas corporation, with its principal office in Henderson, Texas, within this district and division. It owns clay pits and deposits located near Henderson, Texas, and is engaged in the business of mining the clay from said clay pits and manufacturing said clay so mined into brick which it sells throughout the United States. Plaintiff keeps its books on a basis of a fiscal year ending March 31 and uses the accrual system of accounting.

Within the time prescribed by law it filed its income tax returns for the fiscal years ending March 31, 1951, 1952, 1953 and 1954 with the Commissioner. In such returns it took deductions for percentage depletion on the clay it mined from its pits and manufactured into brick. Thereafter such returns were examined by an agent of the In-

ternal Revenue Department who adjusted the deductions for percentage clay depletion and found and determined deficiencies in income and excess profits taxes, which deficiencies, with accrued interest thereon, Plaintiff thereafter paid. The Commissioner found that Plaintiff's clay qualified as ball clay and allowed depletion at the statutory rates specified for ball clay by using the proportionate profits method of determining the gross income from mining provided for by Treasury Regulations 118, § 39.23(m)-1. The total tax paid by Plaintiff for the year ending March 31, 1951, was the sum of $81,612.73. The total tax and interest paid by Plaintiff for the year ending March 31, 1952, was the sum of $93,101.45. The total tax and interest paid by Plaintiff for the year ending March 31, 1953, was the sum of $58,897.68. The total tax and interest paid by Plaintiff for the year ending March 31, 1954, was the sum of $95,361.49. Thereafter Plaintiff filed claims for refunds of income taxes and excess profits taxes paid by it for said four years, said claims having been filed and having been rejected as follows: the claim for the fiscal year ending March 31, 1951, was filed on June 29, 1955, and rejected by the Commissioner on April 13, 1955; the claim for the fiscal year ending March 31, 1952, was filed on June 13, 1955, and was rejected by the Commissioner on April 13, 1956; the claim for the fiscal year ending March 31, 1953, was filed on June 13, 1956, and was rejected by the Commissioner on April 1, 1957; the claim for the fiscal year ending March 31, 1954, was filed on June 14, 1957, and was rejected by the Commissioner on November 13, 1957.

Each of the claims for refund, referred to in the paragraph next above, (1) stated that Plaintiff was the owner of clay deposits from which the clay was taken and made into brick and that the clay was ball clay; (2) referred to and incorporated in such claim Plaintiff's income tax re-

turn for the year in question and the Internal Revenue Agent's report applicable to such return; (3) stated that Plaintiff claims that the depletion allowed by such Revenue Agent's report from the mining of ball clay was erroneous; (4) averred that Plaintiff was entitled to depletion on the clay extracted at the rate prescribed for ball clay (15%) as provided by § 114(b) (4) (A), (iii), I.R.C. 1939, 26 U.S.C.A. § 114(b) (4) (A) (iii); (5) stated that the depletion allowance allowed Plaintiff should have been based on the gross income from mining and quoted the § 114(b) (4) (B) definition of gross income from the property and from mining; (6) stated the first commercially marketable mineral product obtained from its mining of ball clay was finished burnt brick and that all processes requisite to producing the burnt brick were ordinary treatment processes of mining as defined by the Code; and (7) claimed a refund of income and excess profits taxes in specific amounts or such greater amounts as might be due with interest thereon as provided by law. The explanation given in the Revenue Agent's reports recommending disallowance and rejection of such claims was that the Internal Revenue Agent had allowed the depletion computed on the proportionate profits method of determining the gross income from the property and that the Commissioner had not acquiesced in the computation of depletion on the sales price of brick.

In its original complaint the Plaintiff alleged and contended that it sold no clay at any stage prior to the finished brick product; that it had no commercial market for such clay prior to the time it was in the finished brick stage; that such finished burnt brick was Plaintiff's only commercially marketable mineral product; that no commercial market existed in the area of Plaintiff's clay pits for clay in the quantities mined by the Plaintiff other than in the finished

burnt brick state; and that it was entitled to a depletion allowance of 15% of the gross income from the sale of its burnt brick not to exceed 50% of the net income from the sale of its brick. In June 1958 one of Plaintiff's attorneys discussed this case with the attorneys in the Department of Justice who were in charge of the case and agreed that the case should be settled. Following that discussion and at a time when this case was set for trial for July 14, 1958, the parties hereto filed on July 3, 1958, a joint motion for continuance. Among other statements made in said motion were the following:

> "That Plaintiff and Defendant have agreed on all issues of fact and the law of the case except as to one point, and that point is as to whether or not ball clay has any substantial market value in the area of the Plaintiff's operation for other purposes other than the making of brick. That both Plaintiff and Defendant are making their investigation at this time as to such question, and it is the opinion of the Attorneys, both Plaintiff and Defendant, that said cause can be settled without the necessity of further litigation if said cause is continued."

That motion was granted on July 7, 1958. Thereafter the case was reset for trial for September 2, 1958. On August 26, 1958, the parties filed another joint motion for continuance requesting that the case be removed from the settings for September 2, 1958, in order that the parties might be given a further opportunity to settle the case. That motion was granted on August 26, 1958.

By letter dated September 12, 1958, Plaintiff's attorney submitted to the Justice Department its offer of settlement which was that Defendant make refunds to the Plaintiff in the amounts claimed in the original complaint. In said letter the Plaintiff, after pointing out the fact that ball clay substantially the same as Plaintiff's ball clay was at

the stage it was ready for Plaintiff's pug mill was during the tax years in question mined in the Tennessee-Kentucky area and sold, after undergoing processes substantially the same as used by Plaintiff up to the point its clay was ready for the pug mill, as shredded clay or air-floated clay and that there was a national market for such shredded and air-floated ball clay, stated:

> "Consequently, if it be said that on the national market Henderson's first commercially marketable mineral product was unprocessed ball clay it would follow that the prevailing prices for such clay should be used in determining Henderson's depletion deductions; if so, Henderson would be entitled to greater depletion deductions than it now claims—without regard to whether the average prices ($15.50 per ton) resulting from our investigation or the Year Book averages ($10.80 to $12.70) be used."

By letter dated September 27, 1958, addressed to Plaintiff's attorney, the Justice Department acknowledged receipt of Plaintiff's attorney's letter of September 12, 1958, and advised that the Justice Department would obtain the views of the Chief Counsel, Internal Revenue Service, and final action would be taken by or on behalf of the Attorney General.

In October 1958, pursuant to an agreement between the Justice Department and Plaintiff's attorney, an Internal Revenue agent discussed with Plaintiff's counsel the facts stated in Plaintiff's attorney's letter of September 12, 1958, and went to Plaintiff's plant and made inquiry about Plaintiff's clay and made further investigation. Sometime prior to April 16, 1959, this case was again set for trial for May 4, 1959. In a letter dated April 16, 1959, addressed to Plaintiff's attorney, the Justice Department stated, among other things, as follows:

"We have just recently received the results of a supplemental investigation conducted by the Internal Revenue Service and final action with respect to your offer by or on behalf of the Attorney General has not been taken.

"Accordingly, we would appreciate having this case continued generally pending a consideration of your offer by this office. A copy of this letter is being sent to the United States Attorney."

On April 22, 1959, the Defendant filed a motion asking that this cause be again continued because an offer of compromise was then under consideration and attached thereto a letter dated April 17, 1959, written by Plaintiff's attorney to the United States Attorney for this district wherein Plaintiff's attorney, in effect, agreed to a continuance of the case in order that further consideration could be given to Plaintiff's offer of settlement. The last mentioned motion for continuance was granted on April 23, 1959. Thereafter and sometime prior to August 14, 1959, the case was reset for trial for October 12, 1959. On August 14, 1959, Plaintiff's attorney addressed a letter to the Department of Justice requesting that he be advised as to Plaintiff's offer of settlement made in his letter of September 12, 1958. On September 15, 1959, the parties filed another joint motion for continuance stating in said motion that it was believed that if additional time were given, the parties would possibly settle the case. That motion for continuance was granted September 16, 1959. Thereafter the case was again set for trial for January 18, 1960. On December 24, 1959, the Defendant filed another motion for continuance of this cause, and that motion stated in part as follows:

"1. On December 14, 1959, the Supreme Court granted the Government's petition for certiorari in United States v. Cannelton Sewer Pipe Co. (S.D.Ind.) decided June 25, 1958, (2 A.F.T.R.2d 5277), affirmed,

268 F.2d 334 (C.A. 7th); which case involves issues substantially identical to the issues in this case; that is, what is the first commercially marketable mineral product of a particular mineral deposit within the meaning of the applicable statute.

"2. A decision by the Supreme Court in the Cannelton case in all likelihood would be dispositive of the same issues involved in this case."

That motion was granted on December 30, 1959. On January 2, 1960, the Plaintiff filed a motion to set aside the order granting Defendant's last mentioned motion for continuance. A hearing was had on said motion, and on January 8, 1960, said motion was denied. No further settings of the case for trial were made until subsequent to the decision of the Supreme Court in United States v. Cannelton Sewer Pipe Co., 364 U.S. 76, 80 S.Ct. 1581, 4 L.Ed.2d 1581. In the decision handed down on June 27, 1960, the court in that case held that the depletion allowance granted by the Revenue Code to miners for certain minerals, including clay, was to be based on a constructive income from the mineral, i. e., the value of the mineral at the point where ordinary non-integrated miners disposed of their product and not on the value of the finished article manufactured from said minerals. On December 7, 1960, the Plaintiff filed a motion for leave to file an amendment to its original complaint and stated in said motion that in view of the decision of the Supreme Court in the Cannelton case, supra, Plaintiff desired to add a count to its complaint alleging the facts which under the Cannelton case Plaintiff believed required a judgment in its favor. The proposed complaint was in two counts. Count A was an adoption of the original complaint. In Count B, the added count, Plaintiff alleged, in effect, that during the tax years in question there was a market for shredded and air-

floated ball clay identical with or substantially the same as its ball clay, and that said market averaged $10.50 per ton for shredded clay and $20.50 per ton for air-floated clay; that the shredded and or air-floated ball clay was the first commercially marketable mineral product obtained by the ordinary treatment processes applied by mine owners to ball clay; that in the process of mining its clay and manufacturing brick it, by the use of the ordinary treatment processes normally applied by mine owners in order to obtain shredded clay and or air-floated clay, produced shredded ball clay; and that because of such facts, it, if it were not entitled to recover on the basis set forth in Count A of its complaint, was entitled to a refund of income and excess profits taxes determined by using as its depletion allowance 15% of the product of the number of tons produced by it times the value of the shredded ball clay and or air-floated clay. The Defendant made no objection to the filing of said amendment to the complaint. An order was entered on December 20, 1960, granting Plaintiff leave to file said amended complaint and as of that date said amendment was filed. On January 16, 1961, Plaintiff filed its amended answer in answer to Plaintiff's amended complaint but did not allege as an affirmative defense or otherwise that the basis for Plaintiff's claim for refund as set forth in Count B of its amended complaint did not come within the scope of the claims for tax refunds that the Plaintiff filed with the Commissioner.

In February 1961 an employee of the Internal Revenue Service again visited Plaintiff's plant, observed Plaintiff's mining and manufacturing operations, took samples of Plaintiff's clay and discussed with Plaintiff's representatives Plaintiff's mining and manufacturing processes, etc. During the latter part of March 1961 and after this case had been set for trial for April 4, 1961, Defendant, pur-

suant to notice of intention to take depositions previously filed on March 17, 1961, took the depositions, by oral examination, of five ball clay miners in the Tennessee-Kentucky area where substantial quantities of ball clay are mined and developed from said witnesses facts relating to the character of ball clay mined, the methods of mining and treatment processes normally applied by such miners, the commercially marketable mineral products of said ball clay and the prices received by such miners for ball clay, during the tax years in question. Each of said depositions was offered in evidence at the trial.

This case was called for trial on April 4, 1961. After both the Plaintiff and Defendant announced ready for trial, the Defendant, without previous notice to either the Court or to the Plaintiff, filed and presented its motion to dismiss Count B of the amended complaint on the ground that the basis for recovery set forth in said Count B did not come within the scope of the claims filed by Plaintiff with the Commissioner. This was the first time that the Defendant had made such an assertion or contention. The Court reserved action on said motion to dismiss and carried it along with the case. Although the factual basis for Count B was set forth, in effect, in Plaintiff's offer of settlement contained in its letter of September 12, 1958, above referred to, and the Commissioner had such facts before him and investigated them for some two and one-half years prior to April 4, 1961, the date the case went to trial, the record fails to show that the Commissioner ever formally rejected Plaintiff's offer of settlement. However, it must be assumed that the Commissioner acted upon said offer of settlement and decided not to accept said offer sometime prior to Defendant announcing ready for trial even though such decision on the part of the Commissioner was not communicated to Plaintiff.

Section 23 of the Internal Revenue Code of 1939, 26

U.S.C.A. § 23 provides for a deduction from gross income of a depletion allowance on minerals. Section 114(b)(4)(A) authorizes a depletion allowance in the case of ball clay at 15% of the gross income from the property and provides such depletion allowance shall not exceed 50% of the net income of the taxpayer from the property. Section 114(b)(4)(B) defines "gross income from the property" as the "gross income from mining" and "mining" is defined to include not only extraction of a mineral from the ground but also "the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral * * * products, and so much of the transportation of ores or minerals (whether or not by common carrier) from the point of extraction from the ground to the plants or mills in which the ordinary * * * processes are applied thereto." This section further provides that "ordinary treatment processes" in the case of ball clay shall include "sorting, concentrating, and sintering to bring to shipping grade and form, and loading for shipment." When the identity of the depletable product —the commercially marketable mineral product— is determined, the next step is to compute the taxpayer's "gross income" from that product. The Treasury Regulations have long made provisions for certain methods to be used in making that computation. Treasury Regulation 118, Section 39.23(m)-1 provides in part as follows:

> "(3) If the taxpayer sells the crude mineral product of the property in the immediate vicinity of the mine, "gross income from the property" means the amount for which such product was sold, but, if the product is transported or processed (other than by the ordinary treatment processes described below) before sale, "gross income from the property" means the representative market or field price (as of the date of sale) of a mineral product of like kind and grade as

beneficiated by the ordinary treatment processes actually applied before transportation of such product (other than transportation treated, for the taxable year, as mining). If there is no representative market or field price (as of the date of sale), then there shall be used in lieu thereof the representative market or field price of the first marketable product resulting from any process or processes (or, if the product in its crude mineral state is merely transported, the price for which sold) minus the costs and proportionate profits attributable to the transportation (other than transportation treated, for the taxable year, as mining) and the processes beyond the ordinary treatment processes."

The method to be used in computing "gross income from the property" when there is no representative or field price for the mineral product, as provided for by the regulation just quoted, is commonly referred to as the "proportionate profits method." Such method is a computation by which the sales price (covering both costs and profit) of what the taxpayer actually is allocated to mining (the depletable form of the mineral), and separate from manufacturing and other specialized operations, in proportion to the costs attributable to mining.

During the tax years in question Plaintiff was an integrated miner-manufacturer. It owned clay deposits which it mined and manufactured into brick which it sold on the market throughout the United States. It did not sell any of its clay except in the form of bricks. The clay it mined and manufactured into bricks was ball clay. During the tax years in question it mined and made into brick which it sold the following amounts of its ball clay: for the year ending March 31, 1951—53,540.2 tons; for the year ending March 31, 1952—51,755.9 tons; for the year ending March 31, 1953—53,699.3 tons; and for the year ending March 31, 1954—55,387.7 tons.

In mining its clay Plaintiff used the strip mining method. It removed the overburden down to the clay. The clay was then removed by the use of a dragline and loaded into trucks which transported the clay approximately four miles to Plaintiff's plant. As removed from the pit or mine by the dragline, the clay was in large balls or lumps weighing up to 200 pounds. Upon the clay reaching Plaintiff's plant, Plaintiff by the use of a shredder or some other method disintegrated or shredded the clay down to a small manageable size. Upon that being done, the clay was either placed in Plaintiff's pug mill or stored for later use in the pug mill. When the clay was put into the pug mill, certain blending and screening was done and water was added so that it was reduced to malleable form and formed into the shape of brick. From the pug mill, the clay in the shape of brick went to dryers, and from the dryers it went to the kiln for burning and oxidation. The clay came out of the kiln in the form of finished brick and was either loaded for shipment or stored for later shipment.

Approximately 90% of the ball clay mined in the United States is mined in the Tennessee-Kentucky area. During the tax years in question there were a number of persons or firms engaged as non-integrated miners in the mining and selling of ball clay in that area. Like the Plaintiff, those miners used the strip mining method. They first removed the overburden from the ball clay deposit. The ball clay was then removed in large balls or lumps by the use of a dragline or a similar method and loaded into trucks which transported the clay to the mine operator's plant. Upon reaching the plant, the clay was disintegrated by the use of machinery to a small size—about the size of a walnut—which is commonly referred to as shredded clay. The shredded clay was then either loaded for shipment or stored for later sale and shipment or further reduced to

a pulverized—almost powder—size. The clay reduced to the pulverized size was commonly referred to as air-floated clay. The clay miners of the Tennessee-Kentucky area sold shredded ball clay and air-floated ball clay all over the United States. During the tax years in question there was a market for shredded ball clay and air-floated clay all over the United States, and the average market value of shredded ball clay during each of those years was the sum of $10.50 per ton. Therefore, I find that the first commercially marketable product obtained from ball clay is shredded ball clay, and that the processes applied by the miners of ball clay in the Tennessee-Kentucky area to obtain said shredded ball clay are those that must be normally applied by mine owners or operators in order to obtain shredded ball clay. The processes used by Plaintiff in mining and handling its ball clay up to the time said clay is put in its pug mill are substantially the same as the processes applied by ball clay miners in the Tennessee-Kentucky area in obtaining shredded ball clay. Plaintiff's ball clay in the condition it was in at the time it was put in Plaintiff's pug mill was the same or substantially the same as the shredded ball clay marketed by the ball clay miners in the Tennessee-Kentucky area. Thus I find and conclude that the first commercially marketable product Plaintiff obtained in the mining of its ball clay was its clay in the condition it was in at the time it was ready to be placed in Plaintiff's pug mill, i.e., shredded ball clay, and that the processes used by Plaintiff in obtaining said shredded ball clay were the ordinary treatment processes normally applied by owners or operators of ball clay mines in order to obtain shredded ball clay. I further find that during each of the years in question Plaintiff's ball clay in the condition it was in at the time it was placed in Plaintiff's pug mill had an average market value or value of $10.50 per ton.

As above indicated, when the Commissioner examined Plaintiff's tax returns for the years in question, he used the proportionate profits method to determine the depletion allowance Plaintiff was entitled to for its clay and adjusted such depletion allowances so as to allow for depletion the sum of $22,395.61 for the year ending March 31, 1951; the sum of $21,340.50 for the year ending March 31, 1952; the sum of $15,440.80 for the year ending March 31, 1953; and the sum of $20,798.19 for the year ending March 31, 1954. The Commissioner's action in allowing depletion in only those amounts resulted in the deficiencies being assessed against the Plaintiff as hereinabove referred to. In applying such method the Commissioner determined that Plaintiff's mineral product was its clay at the point it was ready to go into Plaintiff's pug mill and all processes applied by the Plaintiff thereafter were manufacturing processes and were not ordinary treatment processes normally applied by mine owners or operators. It must be presumed that the Commissioner found that there was no market for Plaintiff's clay at the stage it was ready to go into Plaintiff's pug mill because the Treasury Regulation permitting use of the proportionate profits method, above referred to, permits the use of such method only when there is no market for the mineral product.[1]

The Plaintiff asserts that the Commissioner was in error in finding that there was no market for its mineral product, and that the Commissioner was in error in using the proportionate profits method. In this connection the Plaintiff contends (1) that the first commercially marketable product obtained by it from its ball clay was the finished brick and that under the holdings in such cases as United States v. Cherokee Brick and Tile Co. (5th Cir.) 218 F.2d 424 and

[1] Alabama By-Products Corp. v. Patterson (5th Cir.) 258 F.2d 892, 900.

United States v. Merry Brothers Brick and Tile Co. (5th Cir.) 242 F.2d 708, its gross income from the property for depletion purposes or its depletion base was the sales price of its brick or (2) that if there were a market for its clay at the stage where said clay was ready to go into Plaintiff's pug mill, its gross income from the property or its depletion base for the purposes of depletion, under the holding in the Cannelton case, supra, should be the value per ton of said clay at the stage it was ready to go into Plaintiff's pug mill times the number of tons of such clay mined and processed during the tax year. A depletion base which is the product of the number of tons of ball clay mined and processed during the tax year in question times the value per ton for said clay at the point it was ready to go into Plaintiff's pug mill, i.e., shredded clay, would be somewhat greater than a depletion base for each of the years in question that was based on the sales price of Plaintiff's brick during the tax year.

Under the findings above made to the effect that Plaintiff's first commercially marketable product obtained in the mining of its ball clay was shredded ball clay, i.e., clay in the condition it was in at the time it was ready to be placed in Plaintiff's pug mill; that Plaintiff's said shredded ball clay had a value of $10.50 per ton during each of the years in question and that the processes used in obtaining said shredded ball clay were the ordinary treatment processed normally applied by owners or operators of ball clay mines in order to obtain shredded ball clay, and, under the teachings of Cannelton, the sales price of Plaintiff's brick during the tax year was not its depletion base. However, under such findings and the teachings of Cannelton, Plaintiff's depletion base or gross income from its property during each of the tax years in question was the product of the number of tons of ball clay mined and

processed by Plaintiff during the tax year times the value per ton ($10.50) of said clay at the stage it was ready to be placed in Plaintiff's pug mill.

Applying the 15% statutory depletion allowance for ball clay to the product of the number of tons of ball clay mined and processed by Plaintiff during each of the tax years in question, as above found, times $10.50, it follows that Plaintiff was entitled to depletion allowance for each of the tax years in question, as follows: for the year ending March 31, 1951, the sum of $84,325.82; for the year ending March 31, 1952, the sum of $81,515.54; for the year ending March 31, 1953, the sum of $84,576.40; and for the year ending March 31, 1954, the sum of $87,235.63. In each instance the depletion allowance just mentioned was less than 50% of the net income of the Plaintiff from its property for the tax year. Therefore, Plaintiff is entitled to recover from Defendant the difference in the amount of taxes paid for each of the years in question and the amount those taxes would have been had Plaintiff been allowed for each of said years the depletion allowance it was entitled to as just found, with interest as provided by law on the overpayments of taxes made by Plaintiff, unless Defendant's contention made in its motion to dismiss Count B of Plaintiff's amended complaint is correct.

Section 7422 of the Internal Revenue Code of 1954, 26 U.S.C.A. § 7422 provides, in effect, that no suit shall be maintained for the recovery of any internal revenue tax alleged to have been erroneously or illegally assessed or collected until a claim for refund has been filed with the Secretary of the Treasury or his delegate, according to the provisions of law in that respect, and the regulations of the Secretary of the Treasury or his delegates established in

pursuance thereof.[2] The pertinent Treasury regulation provides that a claim for a tax refund must be made on Form 843 and further provides that the claim must set forth in detail each ground upon which the refund is claimed and facts sufficient to apprise the Commissioner of the exact basis thereof.[3] Defendant, in its motion to dismiss Count B of Plaintiff's amended complaint, contends that the grounds set forth by Plaintiff in said count were not asserted in its claims for refund filed with the Commissioner as required by the statute and regulation, above referred to, and because said grounds were not asserted in the claims filed before the Commissioner said grounds cannot be asserted as a basis for a recovery in this action.

It is well established that the timely filing of a claim for refund with the Commissioner is a statutory prerequisite to recover taxes alleged to have been illegally assessed and collected. United States v. Felt & Tarrant Co., 283 U.S. 269, 51 S.Ct. 376, 75 L.Ed. 1025; Carmack v. Scofield (5th Cir.) 201 F.2d 360; and Snead v. Elmore (5th Cir.) 59 F.2d 312. The authorities just cited likewise stand for the proposition that, under a regulation requiring that a claim set forth each ground upon which the refund is claimed, a taxpayer cannot in its claim filed with the Commissioner assert one ground and in a suit to recover for taxes allegedly illegally assessed assert an entirely different ground. However, the Commissioner can waive the requirements of the regulation requiring that each ground relied upon by the taxpayer be asserted in the claim filed with the Commissioner and thus permit a taxpayer to assert in a suit to recover taxes a ground that he did not assert in his claim filed with the Commissioner. Angelus Milling Co. v. Com-

[2] Section 3772 of the Internal Revenue Code of 1939, 26 U.S.C.A. § 3772 made like provisions.

[3] Treasury Regulations 301.6402-2.

missioner, 325 U.S. 293, 65 S.Ct. 1162, 89 L.Ed. 1619; Tucker v. Alexander, 275 U.S. 228, 48 S.Ct. 45, 72 L.Ed. 253; Sunland Industries v. United States (9th Cir.) 248 F.2d 768; and Samara v. United States (2d Cir.) 129 F.2d 594 (Writ of Certiorari denied, 317 U.S. 686, 63 S.Ct. 258, 87 L.Ed. 549). As stated by the Supreme Court in the Angelus Milling Company case, supra, "Even tax administration does not as a matter of principle preclude considerations of fairness." [325 U.S. 293, 65 S.Ct. 1165.]

After a careful consideration of Plaintiff's claims for refund filed with the Commissioner, I find and conclude that said claims comprehended, embraced and included the issues tendered by Count B of its amended complaint. Even if it should be determined that the issues tendered by Count B of the amended complaint were not embraced and included in the claims for refund filed by the Plaintiff, I find and conclude that the Commissioner, under the facts in this case as above found, waived the provisions of the regulation requiring the assertion of the grounds forming the basis of Count B in the claims for refund. Therefore, Defendant's motion to dismiss Count B of Plaintiff's complaint is without merit and will be overruled.

During the trial the parties agreed that if the Court concluded that the Plaintiff was entitled to recover and determined the depletion allowance that Plaintiff was entitled to for each of the tax years in question, the parties, upon being apprised of such conclusion and determination, would attempt to stipulate the amount of the recovery Plaintiff is entitled to without admitting the correctness of the Court's conclusions and determinations as to the amount of depletion the Plaintiff is entitled to for each of the tax years in question. In view of that agreement, the parties will be given thirty days from the date of this Memorandum Decision within which to prepare and file as a part of the

record in this case a stipulation as to the amount Plaintiff is entitled to recover in light of the findings and conclusions herein made. Upon such a stipulation being filed, the attorneys for the Plaintiff should present an appropriate form of judgment allowing Plaintiff a recovery in the amount set forth in the stipulation. In the event the parties are unable to reach an agreement as to the amount of recovery Plaintiff is entitled to within the thirty day period, the Court, upon being so advised by the parties, or either of them, will order a hearing for the purpose of determining the amount of the recovery.

As authorized by Rule 52, F.R.Civ.P., 28 U.S.C.A., this Memorandum Decision, together with the stipulation, if any, made by the parties and filed herein as to the amount of recovery Plaintiff is entitled to under the findings and conclusions herein made or in the absence of such a stipulation the findings made by the Court, after hearing, as to the amount Plaintiff is entitled to recover, will constitute the Findings of Fact and Conclusions of Law herein.

GEORGE L. SCOTT, JR., et al.

v.

UNITED STATES OF AMERICA

CIVIL ACTION Nos. 9449-9451

United States District Court
No. Dist. Alabama
Oct. 12, 1960

REMARKS OF THE COURT TO THE JURY IN DIRECTING VERDICTS

LYNNE, District Judge: THE COURT: Gentlemen of the Jury, in the *Scott* cases on trial the defendant filed a motion for a directed verdict at the close of the plaintiff's evidence and renewed it at the end of the case. After I excused you yesterday afternoon I had the attorneys in my office and went over the request for a directed verdict and informed the attorneys that under the law and under the evidence in this case, that there was nothing to submit to the jury and that I would be compelled to grant the motion for a directed verdict.

We fortunately do not have very many of those situations to arise in view of the fact that we have our pretrial conferences, and usually find out then whether or not there is going to be a jury question in the case. These cases were filed before the law was clarified by the Supreme Court.

Last June the Supreme Court decided the *Camilton Sewer Pipe* Case which dealt with the Depletion Statute and the regulations under that Statute. There had been historically a series of cases dealing with that question. The question is upon what is the percentage of depletion to be based? And the Statute itself provides of course the percentage [which] is applied to gross income, but the problem is what gross income. As used in this paragraph

the term gross income from the property means the gross income from mining. The term mining, as used herein shall be construed to be not merely extraction of the ores or minerals from the ground but also the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products.

Now the Courts had placed different constructions, somewhat different constructions on that phrase, "Commercially marketable mineral product." One of the first cases, if not the first case was the *Merry Brothers Brick & Tile* Case that was decided by our Fifth Circuit Court of Appeals in New Orleans. In that case the Court held that the first commercially marketable product under the facts of that case was fire clay—were brick and tile products—that under the evidence there was a negligible amount of fire clay sold on the market. Then the Courts began to add more and more notes to that phrase and finally in the *Cannelton* case and in the *Iowa Limestone* case the Court went a step further and said a product was not commercially marketable unless it could be marketed at a profit and said in substance that they would apply the end use test to an integrated operation where the corporation mined raw materials and processed them and sold manufactured materials.

The Supreme Court reversed the *Cannelton* case and said that it was not lending its support to the *Merry Brothers* case and other cases that had been decided.

So under the evidence in this case it is the overwhelming evidence, indeed all of the evidence is that raw limestone has a market in Alabama, and having a market then the plaintiff cannot claim the benefit of the proportionate profits method in computing its percentage depletion on sales of lime.

The claim for refund in this case was filed when the law was in that state of development or flux and in the claim for refund the taxpayer claimed the right to the use of the proportionate profits method in reliance on two cases, the *Merry Brothers* Case and the *Dragon Cement* Case.

Now then I say that there is no issue for the jury because the claim for refund did not put in issue the representative market price which the agent used in computing depletion. The only point is that the taxpayer says that they are entitled to use the proportionate profits method. The United Sates says you are not because raw limestone has a market, and that is all of the evidence in this case. Therefore, I grant the motion for a directed verdict.

Is there any question in your minds? I like to try to give the jury the benefit of the reasoning when we try these cases and you sit here and hear the evidence.

The record will show that each plaintiff reserved an exception to the order of the Court in granting the motion in each case.

VERDICT

We, the jury, find for the defendant United States of America.

TAX COURT OF THE UNITED STATES

UNITED SALT CORPORATION, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

40 T. C. No. 42

Docket No. 82621 — Filed May 17, 1963.

MULRONEY, *Judge:* The respondent determined deficiencies in petitioner's income tax for the years 1953, 1954 and 1955 in the amounts of $9,678.76, $21,154.52 and $21,828.72, respectively. In an amendment to his answer the respondent claimed an increase of $2,029.07 in the deficiency for 1953, or a total deficiency for that year of $11,707.83.[1] The issues are (1) the correct computation of gross income in the years before us from petitioner's salt mining operations for the purpose of computing the percentage depletion allowance; and (2) the amount of taxable income for the purpose of computing the statutory 50 percent limitation on the allowable percentage depletion. The second issue arises only if the first issue is decided for the petitioner, and, in any event, the second issue applies only to the years 1954 and 1955.

[1] The increase in the 1953 deficiency is based upon facts which have been stipulated. In the statutory notice of deficiency, the respondent computed the allowable depletion allowance for 1953 ($23,784.13), by using a "gross income from the property" of $475,682.71. It was subsequently stipulated that the average net sales price of bulk salt for 1953 was $5.4714 and that 84,445.71 tons of salt were sold in 1953. Based on these stipulated amounts, respondent computed "gross income from the property" (less royalties of $35,843.31) in the amount of $426,192.95, and recomputed the allowable depletion allowance in the amount of $21,309.65.

FINDINGS OF FACT

Some of the facts were stipulated and they are so found.

United Salt Corporation, hereinafter called petitioner, is a Texas corporation with its principal office in Houston, Texas. Petitioner filed its Federal income tax returns for the years here involved with the district director of internal revenue, Austin, Texas. During the years here involved the petitioner kept its books and records on an accrual basis.

Petitioner produces salt (sodium chloride) by dry mining (rock salt mine) at its plant at Hockley, Texas, and is entitled to the percentage depletion deductions at the annual rate of 5 percent for 1953 and 10 percent for the years 1954 and 1955.

The general pattern of petitioner's production from its dry mining operation during the years here involved was as follows. Rock salt was mined in essentially the same manner as that employed by other rock salt companies in the United States. Petitioner mines rock salt by undercutting, drilling and blasting at a level of approximately 1,600 feet underground. The salt after blasting, which is in various sizes ranging from fine grains to chunks of approximately 400 or 500 pounds in weight, is transported from the face of the mine to a storage pile adjacent to the foot of the mine shaft. The salt is then transported from the storage pile to the surface of the ground by a two-ton skip which travels up and down the mine shaft. Upon reaching the surface, the salt is dumped directly from the skip into a hopper leading to the primary crusher. In its passage through the hopper leading to the primary crusher, the salt passes over a series of bars, called a grizzly, which permits the passage of all particles less than approximately 1 inch in diameter, so that these do not go to the primary

crusher but are separated at this point by the grizzly. The passage of the large pieces through the primary crusher results in their reduction to particles ranging in size from approximately 1 inch in diameter down to fine grains. The salt which has gone through the primary crusher is combined with the salt which by-passed the primary crusher by going through the grizzly, and is transferred by conveyor belt to a screening plant. The primary screen in the screening plant permits the passage of all particles less than approximately $^5/_8$ of an inch in diameter. Under the general pattern of operation the salt which does not go through the primary screen passes through a second crushing operation which reduces the particles to sizes ranging from approximately $^5/_8$ of an inch in diameter down to fine grains. The salt is then conveyed over a series of screens which separates the salt into 7 different grades according to size, which, in the descending order of size are designated as number 2, number 1, A, C, little C, stock salt and feed mix. The salt is conveyed by gravity or a belt conveyor to various bins, in each of which is stored one of the sizes named above. As demand for stock salt and feed mix warrants, the larger grades (through "little C") are conveyed from the bins to a roller mill to be ground into stock salt and feed mix.

Some of the salt is sold in bulk, some of it is placed into sacks for loading and shipment, and some of it is pressed into blocks for shipment. Mineral and or a chemical drying agent are added to some of the salt prior to sale, according to the requirements of customers. Ordinarily, petitioner's coarse grades of salt are sold in bulk and its fine grades in sacks. However, some coarse grade salt is sold in sacks and some fine grade salt is sold in bulk.

In 1953, 1954 and 1955 petitioner sold the following amounts (in tons) of salt:

	1953	1954	1955
Bulk salt	20,666.83	20,275.04	19,890.44
Bulk salt in buyers' bags	5,600.10	5,706.65	5,350.83
Sacked salt			
Plain	45,369.00	52,959.76	45,170.38
Mineral	1,636.18	1,195.17	822.08
Block salt			
Plain and broken	4,165.63	4,477.27	4,427.11
Mineral and custom	1,493.88	1,576.56	1,579.71
Sulphur	6,095.73	5,115.20	4,987.31
Brick Salt	21.36	31.66	34.47
Total tons sold	84,445.71	91,337.31	82,262.33

The following schedule shows petitioner's gross sales for the years 1953, 1954 and 1955:

	Gross Sales 1953	Gross Sales 1954	Gross Sales 1955
Mined salt:			
Bulk Salt	$ 179,947.60	$ 198,797.42	$ 190,315.23
Bulk salt in buyers' bags	30,971.75	30,668.49	28,508.68
Sack salt:			
Plain	657,349.09	764,186.25	709,759.38
Mineral	44,347.78	46,772.97	33,452.27
Block salt:			
Plain and broken	60,237.51	76,264.10	71,596.40
Mineral and custom	82,842.01	73,081.90	83,444.52
Sulphur	119,759.69	114,485.60	116,232.65
Brick Salt	1,241.02	1,496.24	1,939.31
Total Mined Salt	$1,175,796.45	$1,306,252.97	$1,235,447.84
Purchased Salt	39,319.04	50,213.97	38,242.61
Gross sales, mined and purchased salt	$1,215,115.49	$1,356,466.94	$1,273,690.45

Petitioner's net sales (gross sales less outward freight and allowances) for the years 1953, 1954 and 1955 were as follows:

	1953	1954	1955
Mined salt:			
Bulk Salt	$ 113,077.62	$ 113,496.46	$ 111986.08
Bulk salt in buyers' bag	28,750.71	29,146.59	27,600.40
Packed salt:			
Plain	546,948.22	650,379.45	573,916.89
Mineral	41,581.28	43,631.83	30,908.63
Block salt:			
Plain and broken	52,650.11	67,903.58	63,134.87
Mineral and custom	73,744.17	68,064.50	78,498.88
Sulphur	111,870.30	109,372.61	108,127.67
Brick Salt	$ 1,236.01	$ 1,968.22	$ 1,864.66
Total mined salt	$ 969,847.43	$1,083,963.24	$ 996,058.08
Purchased Salt	$ 35,867.97	$ 44,673.37	$ 31,610.08
Net sales mined and purchased salt	$1,005,715.40	$1,128,636.61	$1,027,668.16

The average net sales price per ton of all bulk salt sold by petitioner was $5.4714 in 1953 ($113,077.62 divided by 20,666.83); $5.598 in 1954 ($113,496.46 divided by 20,275.04); and $5.630 in 1955 ($111,986.08 divided by 19,890.44).

Direct mining and extraction costs incurred by petitioner in 1953, 1954 and 1955, as shown by the annual audit reports, were as follows:

Year	Tonnage Produced	Total Cost	Cost per ton
1953	85,158.64	$202,762.73	$2.3819
1954	90,717.66	204,430.69	2.2535
1955	83,080.85	200,389.32	2.4121

Direct milling costs incurred by petitioner during the years 1953, 1954 and 1955, as shown by the annual audit reports, were as follows:

Year	Tonnage Produced	Total Cost	Cost per ton
1953	85,158.64	$82,243.62	$ .9658
1954	90,717.66	96,706.25	1.0660
1955	83,080.85	96,217.49	1.1580

Indirect mining and milling costs incurred by petitioner in 1953, 1954 and 1955, as shown by the annual audit reports, were as follows:

Year	Tonnage Produced	Total Cost	Cost per ton
1953	85,158.64	$53,558.90	$ .6289
1954	90,717.66	54,811.00	.6042
1955	83,080.85	38,472.52	.4630

The production costs (exclusive of royalties) after screening of all rock salt sold in 1953 through 1955 were $270,226.42, $292,878.74 and $276,332.39, respectively.

Petitioner claimed depletion allowances in its returns for 1953, 1954 and 1955 or $35,587.50, $81,218.64 and $77,065.55, respectively. Petitioner computed these amounts of depletion allowances as follows:

1953	
Net Sales of Mined Salt	$970,097.43
Less: (Sacking and sewing cost; minerals and chemicals; pressing costs; block cartons; royalties.)	258,347.49
Net Realization	$711,749.94
	.05
Depletion Allowance	$ 35,587.50

1954	
Net Sales of Mined Salt	$1,083,963.24
Less: (Generally similar to 1953 categories)	271,776.86
Net Realization	$ 812,186.38
	.10
Depletion Allowance	$ 81,218.64
1955	
Net Sales of Mined Salt	$ 996,058.08
Less: (Generally similar to 1953 categories)	245,402.55
Net Realization	$ 750,655.53
	.10
Depletion Allowance	$ 75,065.55

Respondent disallowed a portion of these claimed allowances in each year as follows: 1953, $11,803.37; 1954, $40,681.78; and 1955, $41,978.30. Respondent's explanation in each year for the partial disallowances was that "[i]t is determined that for the purpose of computing allowable depletion, gross income from the property should be based on the total tonnage of salt sold, figured at the unit price of plain bulk salt." Respondent's explanation also stated that the "amounts of depletion allowed as deductions in the years 1954 and 1955 have been limited to 50 per cent of the net income from the property as determined herein." Respondent allowed depletion allowances for the years 1953, 1954 and 1955 in the respective amounts of $23,784.13, $40,536.86 and $33,087.25.

At the trial respondent conceded that under the theory advanced by him, i.e., that the proper cutoff point for per-

centage depletion purposes was immediately after petitioner's rock salt had passed through the primary crusher, the 50 percent limitation would not apply for the years 1954 and 1955.

However, respondent, in the second amendment to his answer, claimed increased deficiencies for 1954 and 1955 in the event that this Court should determine that the petitioner's cutoff point for percentage depletion purposes is "immediately after screening and milling," rather than immediately after the product passes through the primary crusher. Respondent alleged that, in that event, the 50 percent of taxable income limitation imposed by section 613 (a) of the Internal Revenue Code of 1954 would apply in 1954 and 1955. Respondent alleged the depletion allowances for 1954 and 1955, if limited to 50 percent of the taxable income from the property, would be $33,920.21 and $16,394.19, respectively.

OPINION

Section 613 (a) of the Internal Revenue Code of 1954[2] provides that "[i]n the case of the mines, wells, and other natural deposits listed in subsection (b), the allowance for depletion under section 611 shall be the percentage, specified in subsection (b), of the gross income from the property excluding from such gross income an amount equal to any rents or royalties paid to or incurred by the taxpayer in respect of the property." Section 613 (b)(4) provides that for sodium chloride or salt the depletion rate is 10 percent, which is the applicable rate for petitioner's years 1954 and 1955. Petitioner's depletion rate for 1953 is 5

[2] This section in the 1954 I.R.C. is essentially the same as its counterpart (section 114) in the 1939 I.R.C. All section references will be to the 1954 I.R.C. unless otherwise noted.

percent under section 114 (b)(4)(A)(i) of the Internal Revenue Code of 1939.

Certain definitions are found in section 613 (c) of the Internal Revenue Code of 1954. Section 613 (c)(1) provides that "[t]he term 'gross income from the property' means, in the case of a property other than an oil or gas well, the gross income from mining." Section 613 (c)(2) states that "[t]he term 'mining' includes not merely the extraction of the ores or minerals from the ground but also the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products, and so much of the transportation of ores or minerals (whether or not by common carrier) from the point of extraction from the ground to the plants or mills in which the ordinary treatment processes are applied thereto as is not in excess of 50 miles * * *." Section 613 (c)(4) defines "ordinary treatment processes" in certain categories of minerals, but does not include sodium chloride.

SEC. 613. PERCENTAGE DEPLETION.

* * * * *

(c) Definition of Gross Income From Property.—For purposes of this section—

* * * * *

(4) Ordinary Treatment Processes.—The term "ordinary treatment processes" includes the following:

(A) In the case of coal, cleaning, breaking, sizing, dust allaying, treating to prevent freezing, and loading for shipment;

(B) in the case of sulfur recovered by the Frasch process, pumping to vats, cooling, breaking, and loading for shipment;

(C) in the case of iron ore, bauxite, ball and sagger clay, rock asphalt, and minerals which are cus-

Respondent argues that "petitioner's 'mining' activity for depletion purposes ceases immediately upon obtaining the first, cheapest, least processed marketable mineral product." That product, argues the respondent, is obtained by petitioner immediately after the rock salt has been processed through the primary crusher (which reduced the rock salt to particles ranging from about one inch in diameter down to grain size) and prior to grade screening, because at that point the rock salt has become ready for industrial use. Petitioner objects to this cutoff point and argues, instead, that it is "entitled to determine the 'gross income from the property,' on the basis of its gross income from the sale of all of its salt products f.o.b. plant loaded for shipment less (a) returns, (b) allowances, (c) freight, (d) purchased salt for resale, and (e) royalties."

In *United States* v. *Cannelton Sewer Pipe Co.*, 364 U.S. 76, the taxpayer, an integrated miner-manufacturer of

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tomarily sold in the form of a crude mineral product—sorting, concentrating, and sintering to bring to shipping grade and form, and loading for shipment;

(D) in the case of lead, zinc, copper, gold, silver, or fluorspar ores, potash, and ores which are not customarily sold in the form of the crude mineral product—crushing, grinding, and beneficiation by concentration (gravity, flotation, amalgamation, electrostatic, or magnetic), cyanidation, leaching, crystallization, precipitation (but not including as an ordinary treatment process electrolytic deposition, roasting, thermal or electric smelting, or refining), or by substantially equivalent processes or combination of processes used in the separation or extraction of the product or products from the ore, including the furnacing of quicksilver ores; and

(E) the pulverization of talc, the burning of magnesite, and the sintering and nodulizing of phosphate rock.

burnt clay products from fire clay and shale, argued that depletion should be based upon its first commercially marketable products (sewer pipe and other vitrified articles). The Supreme Court, after reviewing the pertinent legislative history, concluded "that Congress intended to grant miners a depletion allowance based on the constructive income from the raw mineral product *if marketable in that form*, and not on the value of the finished articles." [Emphasis added.] The record showed that large sales of raw fire clay and shale were made and that a substantial market existed for the raw minerals. The Court then stated:

> Proof of these sales is significant not because it reveals an ability to sell profitably—which the respondent could not do—but because the substantial tonnage being sold in a raw state provides conclusive proof that, when extracted from the mine, the fire clay and shale are in such a state that they are ready for industrial use or consumption—in short, they have passed the "mining" state on which the depletion principles operate. It would be strange, indeed, to ascribe to the Congress an intent to permit each miner to adopt processes peculiar to his individual operations. Depletion, as we have said, is an allowance for the exhaustion of capital assets. It is not a subsidy to manufacturers or the high-cost mine operator. The value of respondent's vitrified clay products, obtained by expensive manufacturing processes, bears little relation to the value of its minerals. The question in depletion is what allowance is necessary to permit tax-free recovery of the capital value of the minerals.

In *Riddell* v. *Monolith Portland Cement Co.*, 371 U.S. 537, the Court again faced this problem. In that case the taxpayer mined limestone, crushed it, transported the crushed product to its plant, and there, through the addition of other materials and further processing, manufactured the limestone into cement which it sold. The Supreme Court

held that the taxpayer's "mining" terminated when its product reached the crushed limestone stage[1] and that its basis for depletion was its constructive income from crushed limestone, i.e., when it first became suitable for industrial use or consumption.

In *Standard Realization Co.* v. *United States*, 289 F. 2d 247, the taxpayer mined quartzite and processed it to varying degrees of fineness. The mineral, in rock formation, was blasted to dislodge it, then blasted a second time to reduce the large rock fragments, which were then further disintegrated by high pressure water jets and by the use of sledge hammers. The granular quartz was then subjected to primary and secondary washing operations. Following the washing operations the granular quartz was dried, then graded into nine sizes by the use of multiple vibrating screens and sold under a trade name. A portion of the grain-sized quartz particles was processed into similar sizes by grinding and sold in various degrees of fineness under another trade name. Taxpayer contended that its percentage depletion should be computed on the net selling price of all grades of its product in bulk and in bags, while the respondent argued that the cutoff point was the value of the crude unwashed silica sand which taxpayer obtained from its deposit.

The Court of Appeals for the Seventh Circuit found that the cutoff point for depletion purposes was after the washing process but before the grinding processes. The Court stated that the so-called treatment processes subsequently

[1] In a footnote to the Supreme Court's opinion in the *Monolith Portland Cement Co.* case it is noted that "crushed limestone was not only 'marketable in that form' but, according to the Bureau of Mines Minerals Yearbook, 1952, p. 26, actual sales in significant amounts of crushed limestone were made in the year in question."

employed were to satisfy the demands of its customers for a more refined product, thereby increasing its sales and profits." After noting that the taxpayer sold in bulk more than 60 percent of its product without grinding or bagging, the Court said that the "fact that the ordinary miner, like the taxpayer, as to the remainder employs further processes in order to obtain a better or more salable product does not alter or move forward the cut-off point." The Court went on to hold that "the taxpayer's depletion base is the gross income it received from the sale in bulk of unground silica sand and what it would have received if all of its product had been sold in that form."

Applying these principles to the instant case, we believe that, for depletion purposes, the cutoff point in petitioner's operations is immediately after the grade screening, since it is at this point that the first commercially marketable product is obtained. Petitioner's executive officer, who showed a wide familiarity with the operation of salt mines throughout the United States and Canada, testified that "[a]ll mines screen their salt." He testified further that during the years 1953, 1954 and 1955 the petitioner did not sell any salt immediately after the primary crusher and prior to screening, and that he did not know of any rock salt mine operator in the United States or Canada that did so. In each of the years 1953, 1954 and 1955 the petitioner sold approximately 20,000 tons of salt in bulk form. Petitioner's bulk salt consisted of *screened* salt of various grades which, after screening, had sometimes been remixed. Ordinarily, the bulk salt sold by petitioner consisted of the coarser grades of salt, though some of its finer grades were also sold as bulk salt in the years here involved.

To show that petitioner's rock salt immediately after the primary crusher, when it consisted of particles ranging in size from approximately one inch in diameter down to fine

grains, was marketable in that form, the respondent relies heavily upon the testimony of the assistant manager of the chemical manufacturing department of Champion Papers, Inc. This witness testified that in each of the years 1953 through 1955 his corporation purchased approximately 3,000 tons of bulk salt for use in its manufacturing operations (which included the processing of chlorine from salt) and that this bulk salt "varied anywhere from dust up to approximately one inch." The witness referred to the type of salt used by his plant in its production as "mine-run fine", and in terms of the various stages in petitioner's operations, the witness identified as "mine-run fine" the rock salt that passed through the grizzly and the rock salt just after passing through the primary crusher.[3]

We do not believe that the testimony of this witness establishes, as respondent contends, that petitioner's product was first ready for industrial use when it passed through the primary crusher. Petitioner's executive officer testified that the so-called "mine-run" salt was "actually a screen salt with the grades put back together from the bin and loaded in a truck or car or a barge." Respondent's witness, who admitted he was not familiar with petitioner's mining operations and, in fact, was testifying merely as to his experience gained as a purchaser of salt, testified that he did not know whether the salt Champion purchased was a mixture of various particles of screened salt. Another of respondent's witnesses admitted on cross-examination that,

[3] We have outlined the several stages of petitioner's operations in our findings of fact. The grizzly is a series of bars which permit passage of all particles less than approximately one inch in diameter so that they do not have to go through the primary crusher. The salt which bypasses the primary crusher is then combined with the salt which has gone through the primary crusher.

as to the term "mine-run fines", "there is a variation in the understanding of what that term means." He also agreed that it was the practice in the salt industry, particularly in the Louisiana mines, to designate as "mine-run fine" anything they found expedient to sell at a low price.

The witnesses generally defined mine-run fines as anything from dust up to one inch particles and it is true this would describe salt before grade screening. However, the evidence shows that mine operators do not normally sell any salt until after the grade screening process. It may well be that some manufacturers could use unscreened salt in their specific operations but there is no general substantial market for such unscreened salt. The statute makes the cutoff point after the ordinary treatment process normally applied by mine operators. We think that point was reached after the grade screening.

Petitioner's contention that it is entitled to determine the "gross income from the property" on the basis of its gross income from the sale of *all* its salt products f.o.b. plant loaded for shipment less returns and allowances, freight, purchased salt for resale, and royalties, is untenable in view of the principles of the *Cinaulton* case and the cases subsequent to it. Clearly, the costs of sacking and sewing are not includable in the depletion base. *Standard Realization Co.* v. *United States*, *supra*. Nor can the processes be included which petitioner employs to obtain a more refined and expensive product. For instance, the block salt sold by petitioner was its finest grade of salt which was screened out, then pressed into blocks by hydraulic press. Substantial amounts of block salt were sold by the petitioner in each of the years 1953, 1954 and 1955. The cost of these additional processes is shown by the stipulated net sales figures of petitioner. For instance, in 1954 the average net sales price per ton of bulk salt sold by petitioner was $5.597

($113,496.46 divided by 20,275.04 tons), while the average net sales price per ton for block salt was as follows: plain and broken, $15.1663 ($67,963.58 divided by 4,477.27 tons); mineral and custom, $43.1728 ($68,064.36 divided by 1,576.56 tons); and sulphur, $21.3819, ($109,372.61 divided by 5,115.20 tons). We believe that these processes employed by petitioner after it obtains its first marketable product, i.e., immediately after screening, must be excluded.

We find that petitioner's depletion base is the gross income it would have received if it had sold all of its salt in the years before us as bulk salt. It has been stipulated that the average net sales price per ton of all bulk salt sold by petitioner in 1953, 1954 and 1955 was $5.4714, $5.5978 and $5.6301, respectively. Petitioner's "gross income from the property" within the meaning of section 613(a) of the Internal Revenue Code of 1954 is, therefore, the total tonnage of all salt sales in each year multiplied by the average sales price per ton of bulk salt sold in that particular year.

Petitioner argues that the respondent, in computing "gross income from the property", used an incorrect amount as the average sales price of salt sold by petitioner in the years 1953, 1954 and 1955. As indicated earlier in the opinion, the respondent computed "gross income from the property" by multiplying the total tonnage of all salt sold by petitioner each year by the average net sales price for a ton of bulk salt.[6] Bulk salt was screened salt,[7] and respondent therefore used the stipulated average sales price per ton of bulk salt in reconstructing petitioner's income at the

[6] It is stipulated that the average sales price per ton of all bulk salt sold by petitioner in 1953, 1954 and 1955 was $5.4714, $5.5978 and $5.6301, respectively.

[7] Petitioner's executive officer testified that ordinarily, coarse grades were sold in bulk, but that some fine grades were also sold in bulk.

cutoff point. But petitioner objects to this figure because most of the bulk sales it made were in the coarser grades which were priced much less than sales of finer grades; also there were certain factors present in respect to some bulk sales[5] that served to depress the price, so the average price it actually received for bulk sales should not be taken as representative of the value of petitioner's production when considered in bulk form.

As pointed out earlier we are here trying to find what petitioner would have received if all of its screened salt had been sold in bulk form. We know of no better way to compute this figure than to take the average price it actually received for bulk sales and consider this as the price it would have received if all sales were in bulk. The price used is a representative average price which properly reflects such governing factors as competitive pricing and freight differentials with respect to a certain percent of bulk sales.

Respondent argues that if we should find, as we do, that the cutoff point for depletion purposes occurs immediately after screening, then the petitioner's depletion allowance for 1954 and 1955 will be limited to 50 percent of taxable income from the property.[6] Section 613(a) of the Internal Revenue Code of 1954, which provides for the depletion allowance based upon a percentage (here 10 percent) of the "gross income from the property", also provides that "[s]uch allowance shall not exceed 50 percent of the taxpayer's taxable income from the property (computed with-

[5] These factors appear to be no more than the giving of cheap prices to some large purchasers to meet competition or compensate for freight differentials.

[6] Respondent concedes that the limitation will not apply to 1953 due to the lower depletion rate (5 percent) under section 114 of the I.R.C. of 1939.

out allowance for depletion).". Respondent's regulations define "'taxable income from the property * * *'" as "'gross income from the property * * * less allowable deductions (excluding any deduction for depletion) which are attributable to the mineral property, including allowable deductions attributable to ordinary treatment processes and mining transportation". The regulations add that "[t]hese deductions include administrative and financial overhead, operating expenses, selling expenses, depreciation, taxes, losses sustained, etc." and that "[e]xpenditures which may be attributable to both the mineral property upon which depletion is claimed and other activities shall be fairly apportioned." Section 1.613-4, Income Tax Reg.

We have found above that the cutoff point in petitioner's operations occurred immediately after screening and that the "gross income from the property" was the total tonnage of all salt sales in each year multiplied by the average sales price per ton of bulk salt sold in that year. The significance of the cutoff point is that, in petitioner's operations, it marks the end of the "mining" stage on which the depletion principle operates, and it is at that point that we must compute both "gross income from the property" and "taxable income from the property". To determine the petitioner's "taxable income from the property" it is evident that "gross income from the property" must be reduced only by those expenditures which are attributable to the mining stage, i.e., through screening, and that some allocation must be made of petitioner's general, administrative and selling expenses which apply to both the mining and non-mining stages. Respondent's regulations recognize the need for this allocation and provide that the allocation should be a fair one. See *Tennessee Consolidated Coal Co.*, 15 T.C. 424; see also *Helvering* v. *Wilshire Oil Co.*, 308 U.S. 90.

Both parties here recognize the need for some allocation of indirect expenses between mining and non-mining stages and both have presented in evidence their computations of "taxable income from the property" reflecting such allocation. It has been stipulated that the administrative and general expenses to be allocated to mining and non-mining activities in 1954 and 1955 are $151,203.44 and $151,883.33, respectively, and the selling expenses to be allocated to mining and non-mining activities in 1954 and 1955 are $96,391.04 and $102,678.76, respectively.

Respondent allocated the general and administrative expenses to mining and non-mining activities for 1954 and 1955 on the basis of the total cost of sales of all rock salt sold. Since the method is the same for both years, it will suffice for explanatory purposes to limit our discussion to 1954. The computations of both petitioner and respondent show that the total cost of sales for 1954 (exclusive of royalties) was $732,428.49. Respondent's computation (Exhibit L) shows that this total consists of the following items: production costs through screening, $292,878.74; selling expenses, $96,391.04; and other direct costs, $343,158.71. Since the production costs of $292,878.74 represent 39.99 percent of the total cost of all rock salt sold, respondent allocated 39.99 percent of the general and administrative expenses, or $60,466.25, to the "mining" stage of petitioner's operations.

Respondent used a different method to allocate selling expenses to mining and non-mining activities. Net sales, rather than cost of sales, were used as a basis for the allocation. Respondent's computation (Exhibit L) shows total selling expenses to be allocated in the amount of $116,289.49 (representing direct selling expenses of $96,391.04 and indirect expenses of $19,898.37). Net sales of bulk salt in 1954 ($113,496.46) amounted to 10.05[illegible] percent

of the petitioner's total net sales of salt in that year ($1,928,353.61). Respondent's computation then proceeds as follows:

Selling expenses allocated to *actual* bulk sales (10.036 percent of $116,289.43)	$11,694.06
Tons of *bulk* salt sold	20,275.04 tons
Selling expenses per ton ($11,694.06 divided by 20,275.04 tons)	$ 0.577
Tons of all salt sold by petitioner	81,337.31 tons
Selling expenses allocated to "Mining activities, i.e., through screening (81,337.31 tons × $0.577)	$52,701.63

Respondent then arrives at the "taxable income from the property" and the 50 percent depletion limitation, as follows:

Production costs through the screening operation, i.e., the mining stage	$292,878.74
Administrative and general expenses allocated to the mining stage	60,466.25
Selling expenses allocated to the mining stage	52,701.63
Total deduction from "gross income from the property"	$406,046.62
"Taxable Income from the Property" ($473,887.05 minus $406,046.62)	$ 67,840.43
Percentage depletion (10 percent of $473,887.05)	$ 47,388.71
Limitation (50 percent of taxable income)	$ 33,920.21
Allowable depletion for 1954	$ 33,920.21

Using the same approach for 1955 the respondent computed the petitioner's "taxable income from the property" in the amount of $32,788.38, which limited petitioner's depletion allowance to 50 percent of this amount, or $16,394.19.[10]

Petitioner also makes an allocation of the general, administrative and selling costs to mining and non-mining activities. Petitioner allocates the general and administrative expense on the basis of direct costs of sales of its various products, while the allocation of selling expenses is made on the basis of net sales of its various products. Up to this point the parties use the same general approach in making the allocation. However, petitioner computes its taxable income from the property by allocating to its mining stage, i.e., through the screening stage, only the general, administrative and selling expenses which it attributes to the salt is *actually* sold in bulk form in 1954 and 1955.

[10] Respondent's allocation to the mining stage of petitioner's operations in 1955 was as follows:

Production costs through the screening operation—the mining stage	$276,332.39
Administrative and general expenses allocated to the mining stage	62,044.31
Selling expenses allocated to the mining stage	56,678.71
Total deductions from "gross income from the property"	$395,055.47
"Taxable income from the property" ($427,843.85 minus $395,055.47)	$ 32,788.38
Percentage depletion—10 percent of $427,843.85	$ 42,784.39
Limitation—50 percent of taxable income	$ 16,394.19
Allowable depletion	$ 16,394.19

Petitioner's computation (Exhibit 47) for the year 1954 will serve to demonstrate the shortcomings of this approach. The exhibit shows that petitioner sold 20,275.04 tons of bulk salt in 1954 and earned a gross profit on its bulk salt sales of $32,881.85,[1] so that its gross profit of bulk salt was $1.6218 per ton. Petitioner then multiplies the cost per ton of bulk salt sold by 91,357.31 tons, the total tonnage of salt in all forms sold in 1954, and arrives at the amount of $148,130.85 (which petitioner labels "Bulk Equivalent Gross Profit."). The remainder of the computation appears as follows:

Bulk equivalent gross profit		$148,130.85
Less allocable expenses:		
Administrative	$15,833.65*	
Selling	11,596.39**	
		27,430.04
Net income		$120,700.21
Limitation—50 percent of net income		$ 60,350.11

* Petitioner obtains this amount by first computing the ratio of cost of bulk sales ($80,614.61) to the total cost of all salt sales in 1954 ($769,820.43) and then applying this ratio to the total administrative expenses to be allocated ($151,203.44).

** This amount is obtained by computing the ratio of net sales of bulk salt ($113,496.46) to total net sales of all salt ($1,128,636.67) then applying this ratio to the total selling expenses to be allocated ($115,323.36).

[1] Net bulk salt sales of $113,496.46 less cost of such sales $80,614.61

There is no justification for allocating to petitioner's mining activities in 1954 and 1955 only those administrative and selling expenses which are attributable to actual bulk salt sales. The computation of "taxable income from the property" must proceed on the assumption that all of the salt of all kinds that was sold by petitioner in 1954 and 1955 passed through the mining stage, i.e., through screening. Each ton of salt sold by petitioner, in whatever form, must therefore bear its portion of the administrative and selling expenses. In 1954 and 1955 petitioner's bulk salt sales made up only 22.2 percent and 24.2 percent, respectively. It thus appears that petitioner's computation, in effect, permits about 75 percent of its salt sold in 1954 and 1955 to be processed through the screening stage without being burdened by administrative and selling expenses. The failure of this approach adopted by petitioner in computing its "taxable income from the property" is evident and must be rejected.

Without assuming for present that respondent's method would in all cases produce a fair allocation, we agree generally with respondent's method of allocating the administration and selling expenses in this particular case. However, we believe he is in error in two of the steps in his computation. It has been stipulated that the selling expenses to be allocated to mining and non-mining activities during the years 1954 and 1955 are $96,290.04 and $102,678.76, respectively. Yet his computation Exhibit 1 shows total selling expenses to be incurred in 1954 and 1955 of $116,280.41 and $125,734.65, respectively. Using the 1954 figures for illustration purposes, it appears that respondent obtained the additional $19,990.37 ($116,280.41 minus $96,290.04) in first computing the percentage of selling expenses ($96,290.04 ÷ total cost of sales $732,428.49, or 13.16 percent, then applying this percent

age to the administrative expenses for 1954 in the stipulated amount of $751,203.44. But a portion of this administrative expense has already been allocated to the mining stage, and its appears that respondent, by carving out a portion of this amount and adding it to the total selling expenses to be allocated, is really allocating that portion of the administrative expense twice. Respondent fails to explain this step in his computation and we can perceive no justification for it. Under the circumstances, the amounts of $19,898.37 and $23,055.89 which respondent adds to the stipulated selling expenses for 1954 and 1955 must be eliminated in computing taxable income from the property in those years.

Decision will be entered under Rule 50.

T. E. TOWNSEND,
Acting District Director of Internal Revenue,
Appellant,

v.

THE HITCHCOCK CORPORATION,
Appellee.

No. 7136.

United States Court of Appeals
Fourth Circuit

Argued March 23, 1956.

Decided April 9, 1956.

Before PARKER, Chief Judge, and SOPER and DOBIE, Circuit Judges.

DOBIE, Circuit Judge.

This appeal is by the United States, through T. E. Townsend, Acting District Director of Internal Revenue, from a judgment in favor of The Hitchcock Corporation, hereinafter called the taxpayer, which is engaged in mining talc at Murphy, North Carolina. Taxpayer's mining activities consist of extracting the talc from its deposit underground, bringing it to the surface, cutting such talc as is suitable for the purpose into crayons, and pulverizing or grinding the remainder of the talc.

The question before us relates to the income tax deduction for depletion for the talc. Specifically, we must decide whether the District Court correctly ruled that the taxpayer properly calculated its gross income from mining under Section 114(b)(4)(B) of the Internal Revenue Code of 1939, to include not only income from the extraction of talc from the ground but also the income from the grinding of

talc to powder, the cutting of talc into crayons, and the packing and bagging of the talc for shipment.

For the tax year in question, 1948, taxpayer claimed a deduction for depletion computed under Section 114(b)(4)(A) of the Internal Revenue Code of 1939, 26 U.S.C.A. § 114(b)(4)(A), in the amount of $41,329.36, equal to 15% of the gross income from the sale of talc which it mined, less the royalties paid on the leased land. The Commissioner of Internal Revenue determined that the taxpayer was entitled to no depletion deduction for that year and assessed a deficiency. The taxpayer paid this sum, filed a claim for refund which was not allowed within six months, and then instituted this timely suit for refund in the United States District Court for the Middle District of North Carolina.

The District Court, sitting without a jury, found:

> "The processes of the taxpayer were those normally applied by mine operators to obtain commercially marketable products. Since the plaintiff's products were not marketable except as crayons or powder the steps necessary to produce these marketable products come within the meaning of mining under the Act and the gross income from the sale of powder and crayons should be the basis for arriving at the 15% depletion deduction." 132 F.Supp. 786, at page 787.

With this we heartily agree. The judgment of the District Court must, therefore, be affirmed.

The taxpayer was entitled for the year 1948 to a deduction for depletion of 15% of its gross income from mining which the Government admits should include the income attributable to the extraction of talc from its mine. The Government refused, and still refuses, to agree with taxpayer that "income from mining" includes income from grinding and bagging talc and from cutting talc into crayons.

and packaging it for shipment. We are told that these processes "do not fall within the definition of "mining" within the meaning of Section 114(b)(4)(B) of the Internal Revenue Code and that this case thus falls outside the limits set by Congress. We think such an argument by the Government is clearly contrary to the language used by Congress.

In computing net income, a deduction for depletion is allowed by Section 23 (m), 26 U.S.C.A. § 23(m):

> "§ 23. In computing net income there shall be allowed as deductions . . .
>
> "(m) In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion . . ."

Subparagraph (A) of Section 114(b)(4) of the Internal Revenue Code provides that in the case of certain mines and other natural deposits, including "talc" mines, the allowance for depletion under Section 23(m) is to be computed as a percentage of "'gross' income from the property", excluding royalties paid in respect of the property. The deduction is also limited to 50% of net income from the property. This limitation is not applicable here. The percentage specified for "talc", which is involved in this case, is 15%.

Subparagraph (B) of the same paragraph defines "'gross' income from the property" as "gross income from mining" and then lays down the general rule that

> "The term 'mining' as used herein shall be considered to include not merely the extraction of the ores or minerals from the ground but also the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products . . ."

This statutory language is clear and unambiguous. Its obvious meaning is that gross income from mining must include the income from treatment processes which must normally be applied to the ore or mineral to obtain "the commercially marketable mineral product or products," that is, the products obtained by the mine owner or operator for which a commercial market exists, the products which are marketable in commerce.

The District Court made the following Findings of Fact: "There is no commercial market for the talc mined by plaintiff before the talc is put in the form of talc crayons or pulverized talc and before such products are packaged or bagged for shipment;" "there are no sales of talc in its crude form as it comes from the mine anywhere in the United States, except for a very small percentage of the national output sold by itinerant miners on the West Coast, who do not have their own grinding equipment;" and "all the processes applied by plaintiff to its talc • • • are the usual and ordinary treatment processes normally applied by mine owners and operators in order to obtain the commercially marketable talc • • •."

In the light of these Findings of Fact by the District Court, and our reading of the Internal Revenue Code, we think it clear that the processes applied by the taxpayer are "ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products," and that such processes are included within the meaning of "mining" as used in the Internal Revenue Code.

Following the provision that "mining" includes the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral products, Section 114(b) (4) (B) provides that

"ordinary treatment processes . . . shall include", in respect to certain ores and minerals, a number of specifically listed processes; and in respect to certain ores, it provides that certain processes are excluded.

The Government argued before us that these lists exclude all of taxpayer's processes except the extraction of talc from underground and bringing it to the surface. First of all, we notice that talc, which is a mineral, is not specifically mentioned in these lists, nor does it appear that any of these four subsections has any application to talc.

Furthermore, the lists of processes are in no way exclusive, even as to the ores and minerals covered. The statute merely states that the term ordinary treatment processes "shall include" the listed processes. Section 3797(b) of the Internal Revenue Code of 1939 specifically states that:

> "The term 'includes' and 'including' . . . shall not be deemed to exclude other things otherwise within the meaning of the term defined."

The District Court stated:

> "Congress clearly provided that the cost of obtaining a marketable product should come within the definition of mining and the same basis should be applied to gross sales. The only limitation by Congress is that the process must be that normally applied by the miner to obtain a marketable product. It seems immaterial whether that process be one of manufacture as in the brick and tile case, [United States v. Cherokee Brick and Tile Co., 5 Cir., 218 F.2d 424], or some other step: that which was essential to obtain the first marketable products, is an expense of mining and the gross sales of the products so mined is the gross income from which the 15% depletion is to be taken." 132 F. Supp. at page 787.

In International Talc Co. v. Commissioner, 15 T.C. 981, it was held that the depletion deduction should be computed on the selling price of the pulverized talc in bags (here, we are concerned in addition with talc crayons). In related fields, see United States v. Cherokee Brick & Tile Co., 5 Cir., 218 F.2d 424, Affirming D.C., 122 F.Supp. 59; and Haviland Clay Works Company v. United States, 1956 P-H Fed. Tax Rep. No. 72,449, which involved the status of the depletion deduction for clay used to produce brick or tile; and New Idria Quicksilver Mining Co. v. Commissioner, 9 Cir., 144 F.2d 918, which involved this deduction for cinnabar ore.

From our review of these cases and the statute, we think it clear that the processes in which taxpayer was engaged are included in "mining" as used in the Income Code and that the District Court properly concluded that the 15% rate of depletion should be allowed on the selling price of both of the taxpayer's commercially marketable products, the pulverized talc and the talc crayons.

The judgment of the District Court is affirmed.

Affirmed.

NEW IDRIA QUICKSILVER MINING CO

v.

COMMISSIONER OF INTERNAL REVENUE

KLAU MINE, Inc., v. SAME

OAT HILL MINE, Inc., v. SAME

WILD HORSE QUICKSILVER MINING CO. v. SAME

Nos. 10589-10592.

Circuit Court of Appeals, Ninth Circuit

Sept. 22, 1944.

Before GARRECHT, MATHEWS, and STEPHENS, Circuit Judges.

GARRECHT, Circuit Judge.

Four petitions for review have been consolidated for hearing here. Three of the petitioners are owners and operators of a cinnabar mine or mines. One is a lessee and operator of such mines. In their respective returns of income and excess profits taxes for the years 1939, 1940 and 1941, each petitioner, relying on the statutory definition of gross income, computed percentage depletion on the total amount received from gross sales of mercury (or quicksilver) flasked, and claimed 15 percent of such gross income as a deduction. The Commissioner notified each that "allowable depletion, based on 15 percent of the gross income from the property as defined in law and regulations, has been determined" in a lesser amount than the taxpayer had computed it, resulting in determination of a deficiency. In each case, the Tax Court sustained the Commissioner's method of computing percentage depletion by deducting from gross income the cost of transporting, furnacing, condensing,

cleaning, etc., in amounts agreed upon together with an assumed profit which was determined by applying to the total profits from sales of quicksilver the percentage which the cost of each operation bore to the total cost of all operations involved in getting the quicksilver to market.

The questions for review are whether petitioners correctly computed percentage depletion in rendering their income tax returns for the years in question; whether the petitioner New Idria Quicksilver Mining Company was entitled to deduct percentage depletion on ore mined from certain dumps on its property; and whether petitioner Oat Mill Mining Company was entitled to deduct as an operating expense a certain service charge deposit required by a power company serving electric energy.

At these mines, with the exception of the metal obtained from the dumps on the New Idria Quicksilver Mining Company property, the mercury was obtained from crude cinnabar ore brought to the surface from underground mining operations. The ore in the mine is broken down by blasting, and then sorted. Only the cinnabar ore is hauled to the surface to be crushed into particles of about two inches. The crushed cinnabar ore is carried to furnaces on the property, where the ore is heated to a temperature of 1200 Fahrenheit. The heat disintegrates the ore and drives the quicksilver off in vapors. The quicksilver as released in vapors is drawn by means of suction into a condenser system. The buckets which collect the condensed mercury are emptied on tables, where slack lime is mixed with the product to cleanse it and also to free the quicksilver. After this final step, the mercury is flasked for market.

Experiments have been made over periods of time with different methods of gravity and flotation in order to concentrate the cinnabar ore before furnacing but they were

not successful. The evidence is undisputed that there are no mills in the United States which purchase the crude cinnabar ore and there is no market for it.

Section 114(b) (4), Internal Revenue Code, 26 U.S.C.A. Int. Rev. Code, § 114, contains the statutory measure of depletion of quicksilver mines:

"§ 114. Basis for depreciation and depletion.

* * * * * * *

"(b) Basis for depletion

* * * * * * *

"(4) Percentage depletion for coal and metal mines and sulphur. The allowance for depletion under section 23(m) shall be, in the case of coal mines, 5 per centum, in the case of metal mines, 15 per centum, and, in the case of sulphur mines or deposits, 23 per centum, of the *gross income from the property* during the taxable year, excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property. * * *" [Italics our own.]

Treasury Regulations 103 interpret Section 114(b) (4) of the Internal Revenue Code:

"Sec. 19.23 (m)-1. Depletion of mines, oil and gas wells, other natural deposits, and timber; depreciation of improvements.—

* * * * * * *

"When used in these sections (19.23(m)-1 to 19.23(m)-28, inclusive) covering depletion and depreciation—

* * * * * * *

"(f) 'Gross income from the property' as used in section 114(b)(3) and (4) and sections 19.23(m)-1 to 19.23(m)-28,

inclusive, means the amount for which the taxpayer sells the crude mineral product of the property in the immediate vicinity of the mine or well, but, if the product is transported or processed (other than by the processes excepted below) before sale, it means the representative market or field price (as of the date of sale) of crude mineral product of like kind and grade before such transporting or processing. If there is no such representative market or field price (as of the date of sale), then there shall be used in lieu thereof the representative market or field price of the first marketable product resulting from any process or processes (or, if the product in its crude state is merely transported, the price for which sold) minus the costs and proportionate profits attributable to the transportation and the processes not listed below. The processes excepted are as follows:

* * * * * * *

"(4) In the case of lead, zinc, copper, gold, or silver ores and ores which are not customarily sold in the form of the crude mineral product—crushing, concentrating (by gravity or flotation), and *other processes to the extent to which they do not beneficiate the product in greater degree* (in relation to the crude mineral product on the one hand and the refined product on the other) *than crushing and concentrating* (by gravity or flotation)." [Italics our own].

Neither the statute nor the regulations mention cinnebar ore, mercury or quicksilver. The petitioners contend that the Regulations intend there shall be no deduction from gross income for the cost of such processes as would bring a non-salable crude mineral to the first stage at which it can be sold. There is no market for the crude cinnabar ore; out of every ton of crude cinnebar ore transported to the surface, 1995 pounds are rock having no value whatever. No salable product is produced by crushing; concentration

has proved uneconomical and is never used; the beneficiation which takes place in the rotary furnace and condensing system is not legally distinguishable from the preceding processes of mining and crushing. The petitioners contend the correct basis for computing depletion is the gross sales of the mercury in flasks as this is the first marketable product. The Tax Court relies strongly on Commissioner of Internal Revenue v. Winslow, 1 Cir., 113 F.2d 418, 133 A.L.R. 405, which fails to support the Government's position.

Much consideration has been devoted to the history of what Congress intended in enacting Section 114(b)(4). We submit that Congress by the 1943 Revenue Act, which is made retroactive, made clear its original intention that the processes to be excepted in arriving at the first marketable product from quicksilver ores should include the furnacing of the same.

Section 124, Revenue Act of 1943, 26 U.S.C.A. Int. Rev. Acts, provides:

"(a) In general. So much of section 114(b)(4) (relating to percentage depletion for certain minerals) as precedes the second sentence thereof is amended to read as follows:

. . . . . .

"(c) Definition of gross income from the property. Section 114(b)(4) is amended by adding at the end thereof the following:

"'(B) Definition of gross income from property. As used in this paragraph the term "gross income from the property" means the gross income from mining. The term "mining", as used herein, shall be considered to include not merely the extraction of the ores or minerals from the ground but also the ordinary treatment processes normally applied by mine owners or operators in order to obtain the

commercially marketable mineral product or products. The term "ordinary treatment processes", as used herein, shall include the following: * * * and (iv) in the case of lead, zinc, copper, gold, silver, or fluorspar ores, potash, and ores which are not customarily sold in the form of the crude mineral product—crushing, grinding, and beneficiation by concentration (gravity, flotation, amalgamation, electrostatic, or magnetic), cyanidation, leaching crystallization, precipitation (but not including as an ordinary treatment process electrolytic deposition, roasting, thermal and electric smelting, or refining), *or by substantially equivalent processes or combination of processes used in the separation or extraction of the product or products from the ore, including the furnacing of quicksilver ores.*" [Italics our own.]

* * *

We believe the interpretation of the regulation by the Commissioner and the Tax Court is not in harmony with the statutes and the intention of the regulation.

The second question for determination is whether the New Idria Quicksilver Mining Company was entitled to claim percentage depletion on income derived from mining dumps on its land. The ore in the dumps has been milled years previously but with improved furnacing process, it was possible to salvage some of the ore. The dumps had always been a part of the land and no depletion had ever been claimed. This court in Commissioner of Internal Revenue v. Kennedy Mining & Milling Co., 9 Cir., 125 F.2d 399, 400, said that "tailings * * * were ores. They were ores from the taxpayer's mine, just as were the newly mined ores." The Tax Court failed to distinguish the instant case and the Kennedy case. There is no legal distinction between the rights of the successor in interest and the rights of the original owner with respect to depletion claimed. See also

Consolidated Collar, Gould & Savage Mining Co. v. Commissioner of Internal Revenue, 9 Cir., 133 F.2d 440.

The final question before this court is whether the Oat Hill Mine Company was entitled to deduct in its tax return the payment made to the Pacific Gas and Electric Company for power service. Tax Regulations entitle the taxpayer to deduct from gross income expenditures incurred in operating its property which do not represent the acquisition of any capital item. The expenditure made by the Oat Hill Mine, Inc., was an advance payment so the power company would install a transmission line to the petitioner's property. The evidence was that the mine had a prospective three year operation. The Oat Hill Mine itself was merely a sublessee of the property. It is our opinion that the operating expense here should have been prorated over the probable life of the operation.

Reversed accordingly.